Savings for Life:

A Pathway to Financial Security for All Americans

THE ASPEN INSTITUTE

INITIATIVE ON FINANCIAL SECURITY

The Initiative on Financial Security

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Statement of the Advisory Board

In December of 2004, we joined the Aspen Institute's Initiative on Financial Security in a groundbreaking partnership between the financial services industry and public policy experts to address the nation's deepening savings crisis. The proposals contained in this volume are the culmination of more than two years of work to craft innovative ways for more Americans—across income levels, and at every stage of life—to save, invest and own.

We questioned top policy experts, economists, finance journalists and business leaders from around the nation to understand the full magnitude of the savings and ownership challenge in America. We asked for their boldest ideas for improving our national savings system and expanding its reach into the area of most dire need: the tens of millions of working families with limited or no savings assets. And we examined ways the financial services industry could design new products, or improve existing ones, to provide fresh savings opportunities for low- and moderate-income households while creating entirely new market opportunities.

Today, we are proud to stand behind this report, which introduces both a new way of understanding national savings policy at the theoretical level and a promising set of pragmatic savings vehicles that can help put more of our citizens on the pathway to financial security. While the details of these recommendations will evolve as they move toward implementation, we believe this is a powerful approach to addressing the country's savings crisis.

We recognize that the savings challenge is not new. But we believe it has reached a critical point. The statistics are compelling. The personal savings rate is currently negative—at its lowest point since the Great Depression—and the national savings rate is the lowest among the G-20 countries. As 80 million baby boomers in the United States approach retirement, we must confront the reality that the vast majority of them do not have enough savings to carry them through their later years.

The financial security of households is not our only concern. Greater savings and investment are also fundamental to the country's economic health, now and in the future.

Today's savings system does provide some opportunities for some households to save for important goals such as education, homeownership or retirement. But it also features structural, system-wide weaknesses that must be addressed.

The status quo excludes significant portions of the population—especially lower-income households that, contrary to popular belief, can and will save more if provided the proper opportunities and incentives. The current savings system is extremely complex, and therefore poorly understood and difficult to enter and navigate. The emphasis on encouraging savings through tax relief, rather than direct government investment, has rewarded primarily the wealthier households who need help least. And the current system has failed to generate an adequate level of savings even among households it does reach.

The time to address the nation's savings crisis is now. Because the financial services industry must ultimately deliver new savings products, it is essential that business leaders lend their knowledge and experience to the process of building a more sensible system for saving.

We are pleased to issue the enclosed report, and look forward to a national dialogue across sectors that ultimately results in a more effective system of saving for all Americans, from cradle to grave.

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Among America's founding principles is the ideal that each citizen's ability to succeed—to achieve financial security, to do better than the generation that came before—should be as limitless as individual potential.

A sound national savings policy is essential to achieving the American Dream. Policymakers have long identified saving as the key to a secure retirement. But the benefits of saving are far broader. Having the opportunity to save at every point in the life cycle enables people to get an education, to buy a home, to start a business, to sustain them in emergencies—all springboards to financial security and upward mobility.

Higher rates of saving can also strengthen the national economy. Greater household assets can lead to a more educated workforce with more employment opportunities, a key to national productivity in our increasingly global economy.

Unfortunately, the savings picture in the United States today is bleak. The U.S. personal savings rate has been declining for decades, sliding from 10.8 percent in 1984 to -1.0 percent in 2006. And our net national savings rate is the lowest among the G-20 countries.

The problem is particularly acute with regard to retirement savings, the most important asset after homeownership for most Americans. Of the bottom 20 percent of households (in terms of income), only ten percent own tax-favored retirement accounts, with a median value of $4,500—a tiny fraction of total retirement needs. The bottom quartile of earners owns just one percent of total retirement account assets. Retirement accounts held by the top ten percent of wage earners have a median value of $130,000—still well short of what they will require for a financially secure retirement.

Most households do not save enough to meet even half of their retirement needs. According to a Congressional Budget Office study, roughly a quarter of baby boomers are completely unprepared for retirement, and another quarter are somewhat unprepared.

A dearth of home ownership—a key means of achieving financial security throughout life and of monetizing savings in retirement—is also contributing significantly to the American asset deficit when viewed in light of racial and ethnic disparities. In 2004, 76 percent of White, non-Hispanic Americans were homeowners, compared with 51 percent of all non-White, non-Hispanic Americans, whose homes were also worth substantially less.

If the current savings situation is dire, it will soon become much worse. The peak years for saving occur in workers' 50's and 60's, after which individual saving characteristically declines. According to the U.S. Census, the percentage of the population over 65 will grow from about 12 percent today to about 21 percent by 2050, a gradual increase in net spenders relative to net savers.

The time to change course is now. The U.S. needs a sensible savings policy that allows all Americans to save, invest and own, at every stage of life.

Today's savings system consists of a confusing patchwork of plans, most of them income-based programs that rely on tax subsidies to generate retirement savings. Unfortunately, those plans are not currently available to many Americans, and they are far too complex for easy, universal use.

More importantly, the emphasis on promoting saving through tax relief disproportionately favors those who already fall into higher income brackets. The government now issues more than $300 billion a year in tax subsidies that primarily benefit those who would save even without the government's helping hand. And more and more working families are left behind.

Simplifying the saving system is a laudable, even necessary, long-term goal. But it is not enough. The government also must step up to the challenge by building durable "on-ramps" to the savings system for low- and moderate-income citizens.

The Unique Approach of the Initiative on Financial Security

The Initiative on Financial Security (IFS) Advisory Board is drawn mainly from the top ranks of executives from the financial services industry. Our unique mission is to bring the expertise of the financial sector to bear on the problem of helping families save. For decades, these two indispensable players in any savings system—the public policy thinkers who provide the ideas for new savings vehicles, and the private firms that must ultimately offer and administer them—have not collaborated in developing savings policy that works for industry, government, and households.

We believe that by truly engaging the best minds in finance, we can find common ground on which to build a new set of savings vehicles that would help more Americans save, invest and own. And at the same time, we can build a vibrant new market of savings product consumers.

We also seek to address another basic market weakness. Nearly half of the nation's households have virtually no connection to the financial services industry because they do not participate in a retirement savings plan, the most widely held savings vehicle. And the business community has not adequately engaged them because it has not perceived their full potential as new consumers.

What is needed is the right nexus to bring the financial services sector and low- and moderate-income Americans together. Given the right savings vehicles with the right incentives for both individual savers and the financial services industry, more Americans can access the pathway to greater savings.

After more than two years of work, we have concluded that five principles should drive savings plans:

- **Savings plans should be targeted to meet needs at every point in the life cycle.** Savings products should promote saving for specific goals—education, homeownership, retirement—that we each face in our lifetime.
- **Savings plans should be universal.** Savings plans should be available to all Americans at every income level.
- **Savings plans should be simple.** Many potential savers stay out of current savings plans because of their complexity. Better plans would be designed with simplicity and ease of participation in mind.
- **Savings plans should include a government match.** Current savings plans rely on tax subsidies, which disproportionately favor high-income households. Better plans would include a government "match" for low- and moderate-income households to provide the right incentives for more Americans to save.
- **Savings plans should be designed in cooperation with the private sector.** The financial services industry has deep experience and knowledge about what does and doesn't work in the market. And they are the ones who must ultimately offer and administer the plans. The industry should play a central role in creating new plans.

Recommendations

Based on those principles, we have developed a package of four complementary savings vehicles that we believe can significantly improve the savings options for all Americans:

- **Child Accounts** to build savings from the beginning of life. All children born in the U.S. would receive a beginning endowment provided by the government to open an investment account. Based on the United Kingdom's Child Trust Fund, this market-based, retail-sold account product would give every child a financial jump start and help build financial literacy.
- **Home Accounts** to be used for a down payment on a home. These FDIC-insured accounts would allow more low- and moderate-income families to become homeowners by providing a government match on their savings.
- **America's IRA**—standardized, simple Individual Retirement Accounts with a government match for low- and moderate-income Americans who do not have access to retirement plans where they work. America's IRA would use existing IRA products and distribution channels and would feature a one-time incentive for opening the account.
- **Security "Plus" Annuities**—basic life annuities to provide an additional layer of lifetime, guaranteed income as a complement to Social Security. It would partner the familiar and universal Social Security program with the private market, and would provide many of the 80 million soon-to-retire baby boomers with a simple, low-cost annuity product that protects them from outliving their savings or losing them in a market downturn.

We believe these savings vehicles can serve as the first steps toward a more sensible system of saving, for every American.

The Case For Change

The opportunity to build a better life has always been an American ideal. Among our founding principles is that each citizen's ability to succeed—to achieve financial security, to do better than the generation that came before—should be as limitless as individual potential.

We at the Initiative on Financial Security believe that a sound national savings policy is essential to achieving the American Dream. Policymakers have long identified saving as the key to a secure retirement, and rightly so. But the benefits of saving are far broader. The opportunity to save at every point in the life cycle drives the ability to buy a home, to get an education, to start a business—all springboards to financial security and upward mobility.

Greater personal saving is not a panacea for all problems, of course, either for individuals or for the economy. But it is clear that helping more Americans save, invest and own must be a major element of any serious effort to build greater household and national prosperity. And that project should begin today.

The savings picture is bleak. Too narrow in its focus on retirement, our savings system also leaves too many Americans out. The current patchwork of savings plans is often redundant and far too complex for easy, universal use. More importantly, the emphasis on promoting savings through tax relief disproportionately benefits those who already fall into higher income brackets. As income goes up, the government's subsidy goes up, too. As a result, the government now grants hundreds of billions of dollars in tax subsidies that primarily benefit those who would save even without the government's helping hand. And more and more working families are left behind.

The lost opportunities aren't limited to low- and moderate-income households. Higher rates of saving can also strengthen the national economy. Greater savings can stimulate economic opportunity through greater investment, both at the national and household levels. That growth, in turn, can help correct America's current account deficit and decrease reliance on overseas investment. An increase in household assets should also provide our workforce with more educational and employment opportunities, a key to national productivity in our increasingly global economy. Expanding that economic potential through a stronger savings policy should be a top national priority.

Unfortunately, the economic indicators show that the United States is moving inexorably in the wrong direction. Our personal savings rate has been declining for decades, sliding from 10.8 percent in 1984 to -1.0 percent in 2006.[1] And our net national savings rate is the lowest among the G-20 countries.[2] Those trends will likely lead to slowing rates of income growth and lower standards of living for the middle class, even as the gap between rich and poor grows wider.

The time to change course is now. Simplifying the savings system is a laudable, even necessary, long-term goal. But it is not enough. The government must also step up to the challenge by building durable "on-ramps" to the savings system for low- and moderate-income citizens.

We need an entirely new approach that will allow all Americans—across income levels and at every stage of life—to save, invest and own.

The State of Saving in America

By any reasonable measure, the level of both household and national saving in the United States is dangerously low.

While the U.S. net national saving rate (or savings as a percentage of gross national income) is zero, the United Kingdom saves 4.1 percent, Japan 5.3 percent, Germany 6.4 percent, and South Korea 19.1 percent.[3] And the personal saving rate (excluding most business spending and government deficits) is at its lowest point since the Great Depression.

Some argue that the current record-high level of household assets makes the low level of household saving unimportant. But the growth in assets is almost entirely attributable to significant increases in capital gains, including equities and housing. And the increased value of those assets, while important, doesn't offset the decline in savings over the long run.

Appreciation of those assets is not likely to be sustainable at the current rates, and does not directly lead to the kind of greater investment necessary to drive economic growth. Also, the rise in asset value today does not necessarily lead to higher investment tomorrow. A sharp increase in the value of a working mother's home, for example, may provide her with the incentives to spend more or work less, but does not make it easier for her children to buy homes. These factors can lead to declines in future national income.

Assets are valuable, in part, because they foster financial stability and economic mobility. But many low- and moderate-income families have no assets, and are therefore less able to plan for the future or pay for unplanned family emergencies, including medical problems, natural disasters and sustained periods of unemployment.

The distribution of assets is even more uneven than income. In 2003, while the average household in the poorest income group had about half the income of the average for all households, it had essentially zero net worth. The bottom 50 percent of households in 2004 had an average net worth of only $23,000, while the bottom 25 percent had no net worth at all.[4]

The problem is particularly acute with regard to retirement savings, the most important asset after home ownership for most Americans. Of the bottom 20 percent of households (in terms of income), only ten percent own tax-favored retirement accounts, with a median value of $4,500—a tiny fraction of total retirement needs. The bottom 25 percent of earners owns just one percent of total retirement account assets. Among the top 20 percent of earners, 85 percent own retirement accounts. Retirement accounts held by the top ten percent of wage earners have a median value of $130,000—still well short of what they will require for a financially secure retirement.[5]

Most households do not save enough to meet even half of their retirement needs. According to a Congressional Budget Office study, roughly a quarter of baby boomers are completely unprepared for retirement, and another quarter are somewhat unprepared.[6]

Home ownership—a key means of monetizing savings in retirement—is also contributing significantly to the American asset deficit when viewed in light of ethnic and racial disparities. In 2004, 76 percent of white Americans were homeowners, compared with 51 percent of minority Americans, whose homes were also worth substantially less. At the same time, 56 percent of all white Americans owned retirement accounts with a median value of $41,000, compared to 33 percent of others, whose accounts had a median value of just $16,000.[7]

The critical state of personal and household saving can hardly be overstated. Low- and moderate-income Americans must save more if they are to reap the full benefits of citizenship—and they can. But the failures of the present system make clear the desperate need for rethinking our national savings policy.

If the current savings situation is bleak, it will soon become much worse. The implications are significant not just for low- to moderate-income families, but for the national economy as well.

The peak years for saving occur in workers' 50s and 60s, after which individual saving characteristically declines. According to the U.S. Census, the percentage of the population over 65 will grow from about 12 percent today to about 21 percent by 2050, a gradual increase in net spenders relative to net savers.[8] That shift means the challenge of increasing personal savings and government savings (because of pressures on Social Security and Medicare) will only become greater.

At the same time, long-term income inequality is at historically high levels and growing worse. A recent analysis of Congressional Budget Office data by the Center on Budget and Policy Priorities showed that increases in income have become increasingly concentrated at the top of the income scale over the past 25 years.[9]

Studies have further shown that the percentage of people who remain mired in the same income bracket over the course of a decade increased in the 1990s.[10] Even as the boom economy boosted pay rates for low-income workers by as much as ten percent in the late 1990s, fewer were able to move on to better jobs. Despite a fairly robust low-income job market, the road to the middle class is crumbling.

The Benefits of Smart Savings Policy

The lack of a sensible U.S. savings policy that promotes financial security at every point in the life cycle is one important cause of the difficulty Americans have achieving social mobility. The benefits of smarter saving are both straightforward and compelling.

Saving—not just for retirement, but throughout life—smoothes the path to the middle class by creating economic opportunities. The ability to buy a car can allow a person to get to a new and better job. The higher income from that job can lead to purchase of a home. Equity from that home can finance a business or a child's college tuition, and so on. Research has also shown that higher levels of assets promote confidence, self-sufficiency and civic engagement.[11]

In particular, more saving leads to greater educational opportunity, a key determinant of financial security. Studies have shown that family assets correlate strongly with child achievement, for a number of reasons.[12] Families with greater assets tend to own homes in better neighborhoods, rather than renting, and for longer periods of time, affording children better and more consistent educational opportunities and resources.

A key driver of career advancement is a college degree. Income of college graduates has soared in recent decades, but these are primarily the children of wealthier families. Unfortunately, higher education remains largely out of reach for most low-income families. The number of low-income students who go on to claim a bachelor's degree has barely budged in 30 years. In 2001, only six percent of low-income students had completed a bachelor's degree by age 24, compared to 19 percent for moderate-income students, and 52 percent for high-income students.[13]

Families are also less susceptible to financial ruin resulting from medical or employment emergencies if they have ready access to assets. Smart saving can literally mean the difference between a temporary setback and a plunge into poverty.

There is no question that saving is difficult for most people. But recent research shows that many do save when they have the right incentives and opportunities.

The Flawed State of the Savings Policy Status Quo

The idea that the United States needs a universal savings policy is not new. But policymakers have focused primarily on income-based plans driven by tax subsidies, most of them geared toward retirement savings. Unfortunately, those plans are currently beyond the reach of many Americans. We need savings policies that enable all citizens to save, invest and own, regardless of income.

The government in 2005 spent an estimated $317 billion subsidizing housing and retirement savings. For the most part, that investment came in the form of tax expenditures, with the rest in direct government spending, primarily for low-income housing. A substantial portion of those subsidies goes to individuals at the middle- or upper-income levels, many of whom would save regardless of government incentives. Because the subsidies are proportional to rates of taxation, a person in the ten to 15 percent tax rate receives a smaller subsidy than someone in the 30 percent tax rate.

Of course, those in higher tax brackets are more likely to already have a college education (and be able to afford one for their children), own a home, and have employment-based savings plans. According to the Joint Committee on Taxation, more than 90 percent of government subsidies for home ownership, for example, accrue to households who make more than $50,000 a year.[14]

Moreover, most tax subsidies are applied to contributions, rather than saving. Many households borrow on one side of their ledger—through a mortgage or home equity loan, for example—while making deposits in tax-subsidized accounts on the other side. Many subsidies therefore go to those who do not increase their savings at all.

The public policy process has also produced its own set of problems for low- and moderate-income households who need to save more.

Thanks to aggressive action by Congress (much of it in the last ten years), there are now eight plans for retirement savings, and relatively new savings plans for education and healthcare. By some measures, savings plans have been a success. They now dominate the private pension system, are highly valued by employees and have introduced millions to equity investing.[15]

Yet today's savings system has serious weaknesses. In particular, work-based plans like 401(k)s often exclude part-time workers, who tend to be low-income, and many employers do not offer plans. Savings rates vary widely, but average savings rates are low among both lower and higher income savers. And because of the sheer number of plans and their complexity, the savings options are poorly understood by both savers and employers, deterring participation.

Repairing all of these systemic flaws would require comprehensive reform, a worthy goal. But there is much we can, and must, do today to build a saving society for all Americans.

What is needed is a fundamentally new approach to saving that leverages existing private market capabilities and helps Americans obtain the basic assets that make financial security possible.

After more than two years of work, we concluded that five principles should drive savings plans:

- **Savings plans should be targeted to meet needs at every point in the life cycle.** Savings products should promote saving for specific goals—education, homeownership, retirement—that we each face in our lifetime.
- **Savings plans should be universal.** Savings plans should be available to all Americans at every income level.
- **Savings plans should be simple.** Many potential savers stay out of current savings plans because of their complexity. Better plans would be designed with simplicity and ease of participation in mind.
- **Savings plans should include a government match.** Current savings plans rely on tax subsidies, which disproportionately favor high-income households. Better plans would include a government "match" for low- and moderate-income households to provide the right incentives for more Americans to save.
- **Savings plans should be designed in cooperation with the private sector.** The financial services industry has deep experience and knowledge about what does and doesn't work in the real world. And they are the ones who must ultimately offer and administer the plans. The industry should play a central role in creating new plans.

We believe the savings vehicles we propose can serve as the first steps toward a more sensible system of saving, for every American, at every stage of life.

The Case for a New Partnership Between the Private and Public Sectors

In the last days of 2004, led by a core group of experts in economic development, pensions and benefits, finance and government, IFS set out to create a team of bipartisan voices to fundamentally rethink the way the United States approaches savings policy.

Our Advisory Board was drawn mainly from the ranks of top executives from the financial services industry. Our objective was to bring the best minds in the business and policy worlds together to identify ways to change the dysfunctional national savings dynamic and, ultimately, to recommend a set of savings products to help more of our citizens save, invest and own.

Our founding premise was that a substantial percentage of the nation's families—mostly low- and moderate-income households—have been unnecessarily left out of our savings system. We believed both data and experience proved that these families can save more, and they do—when offered the right opportunities. But in order to work, savings plans need to create the right incentives, both for consumers and for the financial services industry.

We were inspired by renowned finance writer C.K. Prahalad, author of *The Fortune at the Bottom of the Pyramid*, who challenged us to think beyond conventional approaches and provide innovative financial services that would reach millions of working families who had been left out of the existing savings and investment systems.

Our unique mission was to bring the expertise of the financial sector to bear on the problem of helping working families save. For decades, these two indispensable players in any savings system—the public policy thinkers who provide the ideas for new savings vehicles, and the companies that must ultimately offer and administer them—have not collaborated in developing savings policy that works for industry, government, and households.

The reasons for this lack of collaboration are complex, but a few are instructive:

- The financial services industry has not been persuaded that low- and moderate-income families can save more than they do, even when given the opportunity.
- Industry also believed that even if more families saved more money, the number of new participants would be small, and the scale of their savings would never be large enough to achieve significant profitability.
- While savings vehicles designed to increase savings by low-income families had been a success on a small scale, it has been difficult to extrapolate their likely success, and profitability, on a large scale.
- Policymakers have been suspicious that any solutions supported by industry would contain high and hidden fees that would unreasonably offset the potential gains of lower-income savers.

We believed that all of those premises were demonstrably wrong. And we believed that by truly engaging the best minds in the financial services industry, we could find common ground on which to build a new set of sensible savings vehicles that would put more Americans on the path to saving, investing and owning. And at the same time, we could build new market opportunities through savings products for the underserved.

We also sought to address another basic market failure. Nearly half of the nation's households have virtually no connection to the financial services industry because they do not participate in a retirement savings plan, the most widely held savings vehicle. This lack of first-hand experience with savings products, combined with a widespread financial illiteracy, has discouraged millions of families from seeking out

more opportunities to save. And the business community has failed to engage them because it has not perceived their full potential as new consumers.

What is needed is the right nexus to bring the financial services sector and low- and moderate-income Americans together. Given the right savings vehicles with the right incentives for both the public and the industry, more Americans can access the path to greater savings.

The rationale for partnering with the financial services sector was a powerful one. The industry is hungry for new markets, and eager to understand the way changing demographics—namely the aging of the baby boomers and the accelerating gap between rich and poor—are changing the marketplace. The industry has unique, deep familiarity with the ways in which government can create markets through subsidies, including savings vehicles like 401(k)s and IRAs. And the private sector has built sophisticated marketing techniques to inform consumers and shape the demand for their products.

To be sure, some companies are focused on serving the mass affluent and high net-worth markets. But many of the biggest players are eager to investigate new market opportunities for improved savings vehicles. Some of the companies on the Advisory Board were prescient enough to see the extraordinary market opportunities presented by low- and moderate-income households. And others see the benefits of being ahead of the curve. By joining the policy process by which new savings policy is developed, they can add their unique expertise in the debate and help us understand how to craft policies that work not just for families, but also in the American marketplace.

Our approach was well-summarized by one of our member CEOs. He commented that what was unique about the IFS approach was that the problems we sought to tackle—retirement security, college affordability, homeownership, children's savings and building financial literacy—have long been viewed as essentially public problems, or matters of individual responsibility. In fact, they are problems that invite the advice and insight of financial leaders whose institutions provide the backbone of the American savings system.

Our objective was to bring the best thinking on both the policy and business sides of the equation to bear. The result is a set of savings policies that can substantially improve the savings picture for all Americans, even as they enhance the business bottom line.

As we worked to assemble a set of sensible savings products, our Advisory Board executives often acknowledged that these new vehicles would not always be profitable at the early stages. But they believe that they have the potential to become so.

We have worked to build on the lessons of the marketplace by keeping what works about existing savings policies. IRAs and annuities, for example, are standard market vehicles. But we have rethought them from the ground up and added new features designed to make them more accessible and useful to a much broader potential market audience.

All four of the products we now propose have been vetted by product teams and executives who have closely analyzed them to determine how their institutions could offer them at a sustainable level, and have made important recommendations on key features of product design.

The end result is a set of savings vehicles we believe can help more Americans save, invest and own—all indispensable steps on the path to the American Dream.

Savings for Life: Four Recommendations

Child Accounts: Beginning at the Beginning

Saving, like every other good habit, is best learned at the beginning of life. An earlier start on saving means more money in the account through the magic of compounding. And it instills a saving mindset that can persist throughout life.

Child Accounts provide the first crucial savings opportunity. From birth, every child should have an investment account initially funded through a modest government contribution. Contributions from family and friends and matching contributions for low-income children, along with investment earnings, would help the account grow. Child Accounts can also provide a hands-on opportunity for teaching financial literacy.

Every child at age 18 would have a head start for entering adulthood—to invest in education, to buy a car or pay for work-related expenses, to start a business, or to help rent or buy a first apartment or home.

Basic Features

- At birth, each child would be given a $500 certificate for an investment account.
- Parents would take these certificates to a participating financial institution to open an account that would grow tax-free.
- Family, friends, churches and charities would be able to add up to $2,000 a year in new contributions.
- Low- and moderate-income families would be encouraged to save through a 100 percent government matching contribution up to $1,000 annually ($2,000 maximum on all account contributions).[16]
- The standard Child Account would have a simple design, one basic investment fund structured for an 18-year investment horizon, and limits on account fees and expenses.
- Account funds would be locked up until the child reaches age 18. Then, assets could be used for any purpose, with incentives for use towards education, home ownership, business startup or retirement income.

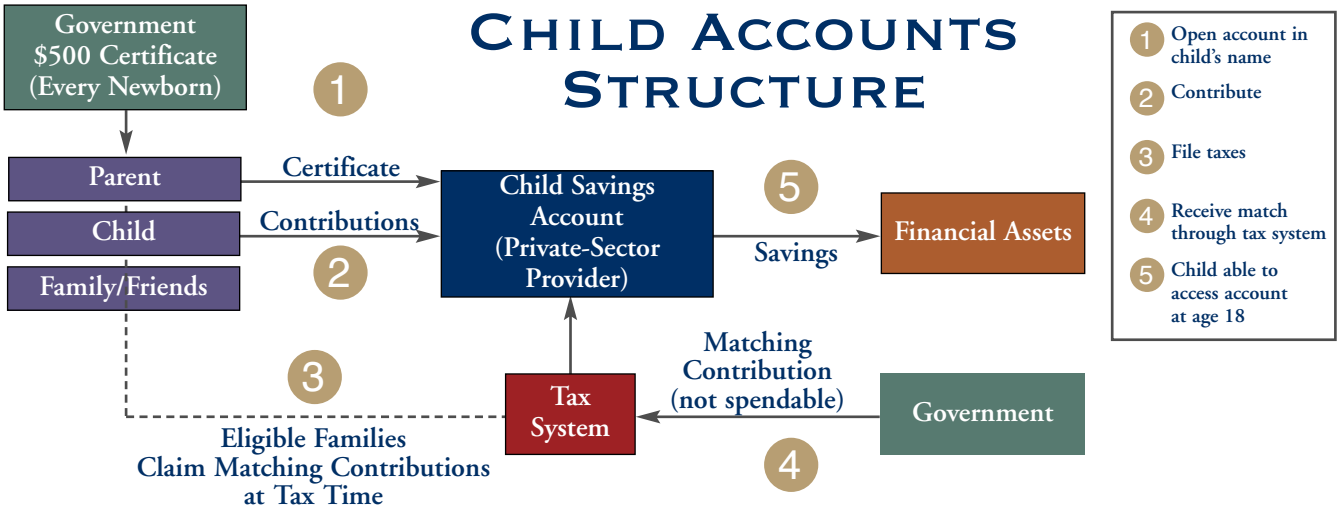
Why Child Accounts are Different – and Necessary

The U.S. savings system today doesn't include a vehicle like Child Accounts—a universal, tax-favored, private-sector investment account with unrestricted access to funds at age 18 and personally owned by children themselves. The federal government currently doesn't invest in children through savings accounts with start-up or matching contributions. And there is no savings account that is universally available to all children.

Today, anyone can open a standard investment or savings account or state-law custodial accounts for a child.[17] These accounts enjoy no special tax benefits and their growth can, in fact, be adversely affected by the federal "kiddie" tax.[18] Federal law does include two tax-favored accounts for children: Coverdell IRAs and state-based 529 plans. Both accounts reserve tax benefits largely for assets spent on education (only higher education in the case of 529 plans). In these accounts, contributors can change the name of account beneficiaries at any time or even withdraw contributed funds, subject to some tax penalties.

The Child Trust Fund Model from the United Kingdom

Though Child Accounts are an American idea, they do not yet exist in the U.S.[19] They do, however, exist in the United Kingdom as the Child Trust Fund.



The U.K. launched its universal child account program in 2005. It gives families of all newborns a voucher for 250£, or about $500, with children from low-income families (roughly 35 percent) receiving an additional 250£.[20] Families open a Child Trust Fund (CTF) for the child by redeeming the voucher with a participating private-sector institution.

The theory behind CTFs is that the opening of an account and the initial government contribution will stimulate additional contributions by families and friends. The U.K. permits contributions up to 1200£ or roughly $2,400 each year. CTFs belong to the child, and at age 18, assets may be withdrawn from the account for any purpose.

In the U.K. model, private-sector institutions service CTFs—including marketing the accounts (and receiving vouchers), facilitating contributions, keeping track of contributions, making and changing investments and sending out annual statements. To pay for these services, the provider charges a variable fee, but no more than 1.5 percent of the account's value each year.

Although the U.K. experiment is new, its initial reception and experience are promising. A baseline survey by the University of Bristol of parental behavior before and after the introduction of these accounts reveals positive effects on savings behavior.[21]

Competing Proposals

There have been several proposals for savings accounts for children in the United States. These plans do not use a private-sector delivery model, but instead would create a new federal program for the accounts. Most of these proposals haven't promoted general-purpose saving, but would restrict the use of the accounts to special purposes such as education, home purchase or retirement. Furthermore, many do not feature an initial government endowment or continuing matching contributions.

Several child account proposals have actually been designed to help fix the retirement security issue. The dollars in these accounts are not intended to launch children into adulthood, but are reserved for their retirement years.

The most widely promoted proposal, the ASPIRE Act, would create universal accounts with a $500 endowment and additional matching contributions for the poorest families.[22] The initial endowment would have to be repaid by age 30. Investments would be offered through the Thrift Savings Plan for federal employees, and young adults could make withdrawals after age 18 for home-ownership, higher education, or retirement. The ASPIRE Act does not involve the private sector in the marketing and administration of these accounts, clearly setting it apart from the U.K. model.

Why Child Accounts Are The Way Forward

We propose a savings vehicle that puts all children on the path to financial security from the very beginning of life.

Child Accounts would be universal—each child, regardless of income, would receive a jump start in life. They would be delivered through the private market and administered by financial services companies. The federal government would provide matching contributions for low-income families and would regulate the accounts.

Child Accounts would also be simple, with limited, basic investment choices, and would allow no withdrawals for 18 years. They would impose no restrictions on the use of the accumulated assets at age 18, allowing young adults to choose what to do with their savings—whether they help pay for their education, purchase a car that enables them to commute to a new job, put a down payment on a home or continue to save.

Benefits and Costs

- The plan would require a $2.1 billion public investment for the first year, and $26.6 billion over 10 years ($20.7 billion endowment; $5.9 billion match).
- After the first three years, private contributions and investment income exceed the government's initial contribution.
- Based on modest family contributions and investment growth, this market is projected to reach $100 billion over ten years.
- With a $50 per month contribution (or $25 with a match), the accounts would be worth about $16,000 (about $10,000 in today's dollars) in 18 years. That amount would pay for two years of tuition at a community college today, as well as a third year at an in-state public college. This amount would also be significant seed capital to start a small business or purchase a business franchise.

Questions and Answers about Child Accounts

Why should affluent children get $500 from the government? Is this the best use of limited government resources?

Child Accounts aren't a social welfare, anti-poverty program. They don't pay for benefits and services today. Instead, they are a long-term investment in children and their financial futures.

They are available to all children for two reasons. First, it isn't possible to predict which children, seemingly wealthy at birth, will be poor at age 18—and vice-versa. Second, a universal program makes saving a universal experience and a hands-on lesson in financial literacy for all children. Universality also includes everyone connected with a child in a real-life experience that teaches better saving and investing skills and boosts the financial aptitude of adults as well as children.

Why should some children get matching contributions but not others? Can low-income families really save, or will these matching contributions be ineffective?

The matching policy explicitly helps children from poorer families keep pace. For example, many of these families would not be able to contribute $166 each month ($2,000 a year). With the match, they could reach the same $2,000 with a more feasible contribution of $83 a month.

Although a matching policy would add some degree of administrative complexity to Child Accounts, the positive behavioral effects are well worth it. Experiments in the U.S. have shown that matching contributions can be a powerful incentive for saving among low- and moderate-income families. In addition, matching contributions help small accounts grow more quickly, providing larger balances at age 18 and making the account economics more attractive to financial institutions.

How large could Child Accounts be at age 18?

That depends on the amount of contributions, their earnings, and limits on account fees. A child who receives only the initial $500 government contribution would have over $1,200 (over $700 in today's dollars) in the standard lifecycle investment, net of all fees. On the other hand, a child who receives the maximum amount of contributions each year would have about $55,000 (about $33,000 in today's dollars) at age 18.

Why should we have a private market model for these accounts? Wouldn't a government-run system like the TSP be cheaper?

There are many advantages to a retail model. Child Accounts will have over four million new accounts each year (compared to 700,000 in the U.K.). Most of those accounts will be small and remain small.

The private sector currently manages millions of accounts, many of them small, for employer-based plans. In addition, the private sector already has many large players with the relevant account administration and investment management systems that Child Accounts will require. The 401(k) plan market is competitive, for example, which drives down costs to savers. The private sector also has the relevant marketing, communications and financial education materials that would help increase contributions to accounts.

The government Thrift Savings Plan is a well-run, low-cost program. Its direct costs are kept low in part because government agencies absorb the cost of the necessary administrative services. TSP accounts are also relatively large (about $50,000 on average) which helps reduce the fees charged to individual accounts. Scaling up the TSP for Child Accounts would be a challenge, and the ultimate costs to taxpayers and to accounts are uncertain.

Would private-sector financial institutions offer Child Accounts? Would they be able to offer these accounts if fees were limited?

A universal program of child accounts would appeal to the financial industry. Many financial institutions would offer these accounts, while others would likely follow the practice in the U.K. of partnering with retailers and other institutions. Successful operation in the child account market will depend on companies being able to obtain a significant market share of accounts and maximize contributions to build account size.

Capping the fees would challenge the industry. But the blend of simple account structures and standardized customer choices would keep costs low. If fees were limited to 1.5%, as they are in the U.K., the initial revenue on a $500 account would be a modest $7.50. To make these accounts profitable, the private sector would have an incentive to continually encourage families to make additional contributions to accounts—an incentive that would be missing in a government-delivered program.

Why not begin the program through the government and allow the private sector a larger role at a later date?

Situating the accounts in the private sector from the beginning allows families to develop an initial relationship with a financial provider who will seek from inception to maximize deposits. Moreover, for many families, sending monthly contributions to a familiar financial provider may be more appealing than using a new government entity. And it is these early deposits that have the time to grow and encourage a habit of thrift and investing in families.

Practically speaking, establishing a two-track system is more costly to taxpayers and less efficient. Even holding accounts for the first five years would mean building a new government system to keep records and manage money for some 20 million account holders—a program seven times as large as the federal Thrift Savings Plan.

How can we trust young adults to spend these funds wisely without restrictions? Won't they misuse the funds or become prey to other schemes once they have control of the funds?

Child Accounts encourage choice and responsibility as a first step for young adults to secure their futures. While many would use their accounts for higher education, others may need to buy a car, a suit or a computer to get to a first job. They should have choices, because it is their money. Furthermore, unrestricted use would avoid building costly infrastructure to police the use of these accounts.

Some children may waste their funds, of course. Some will indeed fall prey to the schemes of others—and they would be able to turn to the legal system for recourse. But many others will make good choices. Adopting the U.K. model of unrestricted use is a risk we choose to take, knowing that we have 18 years to teach these children, and their families, about basic financial principles and skills.

Child Accounts in the Real World

Delroy is born to Fran and Al in Jefferson, Iowa, on February 2, 2008. Al is a custodian at the local elementary school, and Fran works part-time as a secretary at a nearby medical practice. In a good year, Fran and Al together earn about $38,000.

Fran and Al take Delroy's $500 certificate to their local bank and open a Child Account. They decide to invest in the age-based equity investment fund. Fran and Al decide to contribute two percent of their income, or about $760 every year, to Delroy's account. Fran's parents contribute another $200 every year and Al's sister adds another $150 annually. Delroy also qualifies for a matching contribution of $900 annually from the federal government.

Assuming Delroy's account grows at a six percent rate, he will have over $67,000 in his account at age 18 (or about $39,000 in today's dollars). That will more than pay (again, in today's dollars)[23] for four years of tuition at the state college 40 minutes away from home.

Home Accounts: The Foundation of the American Dream

Buying a home is an important milestone in adulthood. Beyond securing the basic human need for shelter, becoming a homeowner helps establish solid membership in the American middle class. And home equity, as a financial asset, can be a springboard to the acquisition of other important assets like a college education, a small business and a secure retirement.

By offering a modest government matching incentive of $5,000, Home Accounts would encourage millions of low- and moderate-income Americans to save for a down payment on a home.[24]

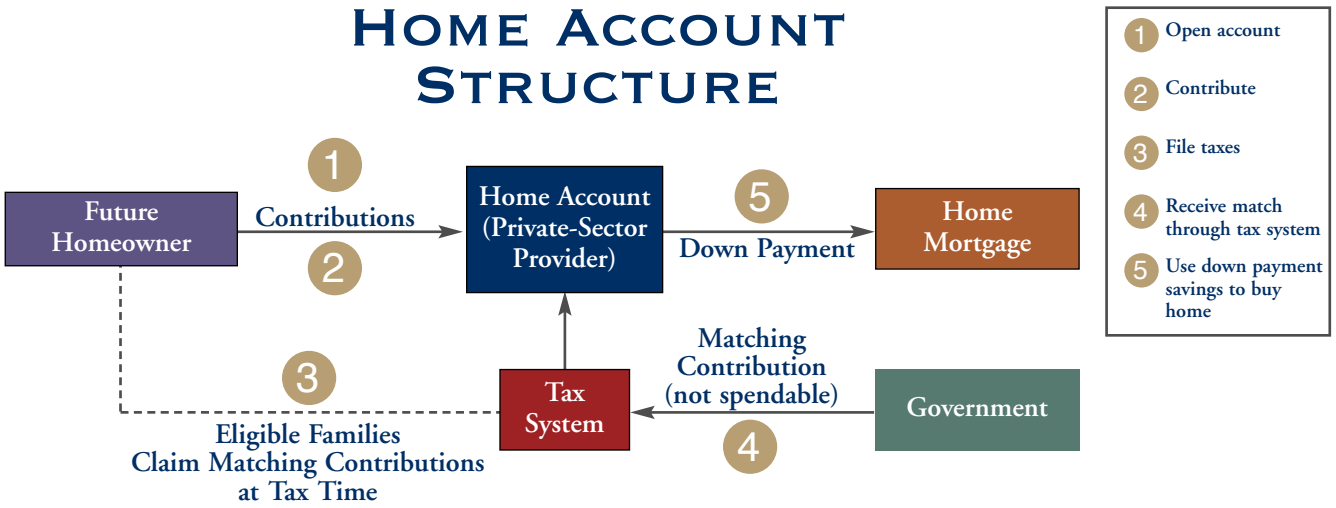
Basic Features

- Home Accounts would be FDIC-insured. Interest rates paid on these accounts would vary by participating financial institutions.
- Low- and moderate-income savers would get a 50 percent federal match to their contributions, up to a lifetime cumulative cap of $5,000.[25]
- Matching contributions would be delivered through the tax system and directly deposited in accounts.
- Account assets could only be withdrawn for down payment and closing costs when buying a home. Penalties would apply for withdrawals used for other purposes, but accounts could be converted into retirement accounts.

Why Home Accounts are Different—and Necessary

The U.S. savings system today does not reward short-term savings for a specific purpose like buying a home. Yet assets in the form of home equity directly lead to greater financial security. For the American population as a whole, the value of assets in a primary residence exceeds the value of retirement accounts.[26] Because minority and lower-income Americans have lower rates of homeownership, they lag far behind in this key component of financial well-being.

Housing advocates have advanced many different approaches to stimulating homeownership: expanding bank lending by changing what secondary markets will purchase, developing alternative credit scoring assessments, building second mortgage pools



that have the effect of reducing the housing prices in high-cost markets, and providing subsidies to developers, among other ideas.

Yet a growing body of work is focused on the down payment. Two approaches have been suggested. One approach eliminates the need to save for a down payment by offering zero-down-payment mortgages—in other words, through 100 percent financing. These mortgages require homebuyers to assume more debt and increase the ultimate costs and risk. More debt just increases the risk of foreclosure and bankruptcy. This is a bad policy for working families who would be better served by saving more and borrowing less.

Helping buyers have more cash in hand when purchasing a home is the second approach. We believe this is by far the better approach for working families.

A down payment account policy is based on the positive results of years of experiments with Individual Development Accounts (IDAs). IDAs provide matching dollars to reward personal savings toward a home, small business or education. Their success has shown that there is both capacity and interest among working families to save in a more structured way.

The results of the controlled study portion of the American Dream Demonstration are instructive. Among participants in this IDA study—all of whom had an average household income of under $18,000—the homeownership rate increased by 14 percent compared to non-participants.[27] IDAs for homeownership have been successful even in high-cost housing markets like San Francisco.[28]

Providing government savings incentives to help Americans save to buy homes is also a real key to addressing racial disparities in home ownership. While 76 percent of white families own their own homes, this is true for only 51 percent of minority families.[29] These disparities have been troublingly persistent. Even though minorities comprised 49 percent of new homeowners between 1995 and 2005, the percentage of minority homeowners remains 25 percent behind that of white families.[30]

Persistent lower rates of homeownership among minority and low-income households will not be solved by increasing their debt and risk through zero-money-down mortgages. For families struggling to save, Home Accounts are a sensible way to bring the dream of homeownership closer to reality. Making the savings side of the home ownership equation more robust is a smart use of public dollars to help create a pipeline of financially prepared homebuyers.

Why Home Accounts Are The Way Forward

Home Accounts take the successful IDA experiments one significant step forward by delivering matching contributions directly into a savings account. While these accounts may be modest in size ($15,000 if the full match is gained), they could represent an important new market of savers for the private sector.

Benefits and Costs

- Home Accounts would open homeownership opportunities to millions of low- and moderate-income families.
- In five years' time, Home Accounts are conservatively projected to create a market of $35 billion in assets and would leverage $60 billion in new mortgages each year.
- Prospective homeowners will have an alternative to zero-down-payment mortgages through a structured and matched savings program.
- Financial institutions would have a ready pool of active savers who will become mainstream mortgage clients.
- Annual costs are expected to range between $2 billion and $4 billion, with an expected five-year cost of $10 billion.

Questions and Answers about Home Accounts

Why would a low- or moderate-income household participate in this program?

A savings match program that adds up to $5,000 to

down payment and closing cost funds would enable low- to moderate-income Americans to buy a home with less debt and less risk of foreclosure.

How many low- and moderate-income families could open accounts and eventually become homeowners as a result of this policy?

During the first five years, up to 4.5 million Home Accounts are projected, the majority of which are expected to be used for the purpose of buying a home.

Why would a financial institution participate in the Home Accounts program?

After five years, financial institutions could expect to tap into a projected $35 billion savings pool. While these accounts are modest in asset size, financial institutions would also be able to convert these assets into mortgages. Home Accounts are expected to generate $60 billion in annual mortgages within five years. Because the Community Reinvestment Act provides credit for lending to underserved communities, it is also possible that an additional CRA credit could be offered to institutions that offer these accounts.

What challenges do financial institutions face in offering Home Accounts?

These accounts are nearly identical to standard savings accounts, so any additional operational and administrative challenges should be minimal.

What happens to the account if the saver does not buy a house?

The account could be converted, without penalty, to a retirement account.

Home Accounts in the Real World

Francine is also born in Jefferson, Iowa, on February 2, 2008. Her parents open her Child Account at the same bank and invest it the same way as Delroy's parents did. Her family is able to contribute $1,000 to her account every year for five years, and the government gives her the full $1,000 annual match. But then her father dies, and no more contributions are made to her account.

When Francine turns 18, her account is worth about $27,000 (about $16,000 in today's dollars). She uses her account to train as a hairdresser and then opens up her own small business. She earns about $28,000 a year (in today's dollars) in most years.

Francine would like to buy her own home and move her business there. So she opens up a Home Account. She contributes $2,000 each year for five years and earns a $1,000 match from the federal government each year, too. After five years, Francine has over $16,000 in her account—the result of her savings, her interest and $5,000 of government matching money which she tapped each year at tax time. She uses her entire account to pay a down payment and closing costs on a house costing $110,000. Francine gets a 30-year fixed-rate mortgage of 6.125 percent, which gives her monthly mortgage payments of $571–even lower than what she had been paying in rent. She now has home equity valued at $14,000 in her home.

America's IRA: Building Retirement Security for Working Americans

Building enough savings for a comfortable retirement is an essential part of the American Dream. Congress has put considerable effort into crafting a better national system for retirement saving. And yet, despite decades of work, most working Americans will not have saved enough to enjoy a financially secure retirement. The problem will only grow worse as 80 million baby boomers leave the workforce, stretching limited public resources.

America's IRA moves low- and moderate-income Americans toward greater income adequacy in retirement through good incentives for long-term saving. Its simple plan design allows the private sector to offer a profitable and simple savings vehicle through existing platforms.

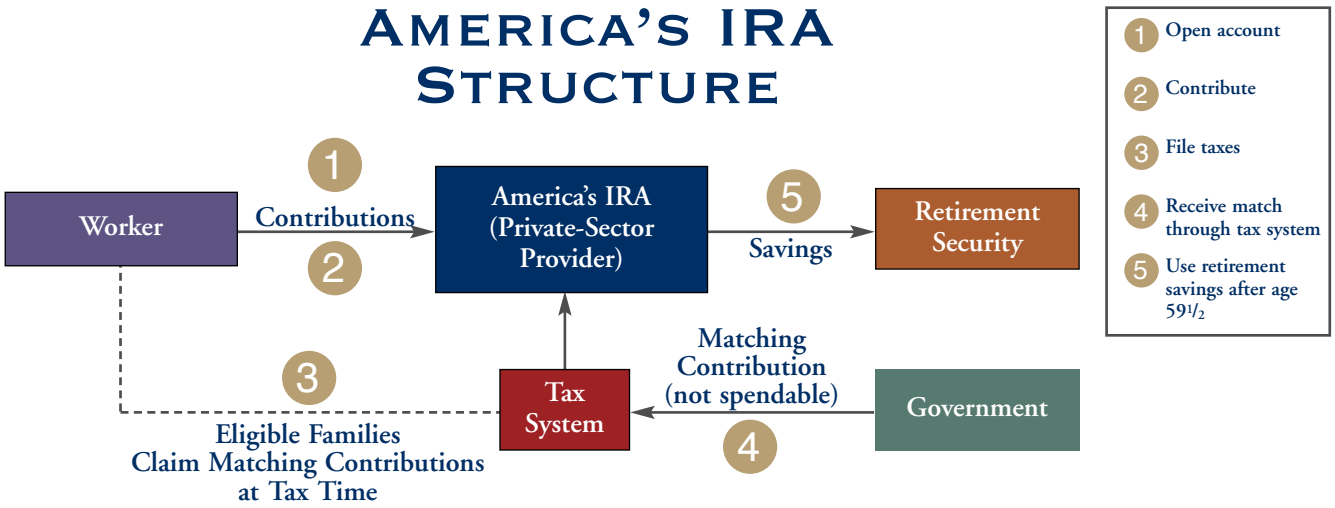
Basic Features

- The plan uses the existing IRA structure rather than creating another savings plan. The same financial services firms that offer IRAs today could easily offer America's IRA.
- America's IRA offers an annual dollar-for-dollar match, capped at $2,000 to savers earning under $40,000 (a partial match is available up to $50,000).
- The plan would also offer a "toaster:" a one-time incentive of $1,000 to those earning below $12,500, with a partial payment for incomes between $12,500 and $30,000.
- Matching contributions are deposited directly to accounts through the tax system.

To make savings simple, America's IRA offers only two investment options: an age-based mutual fund, and a risk-free principal preservation product.

Why America's IRA is Different—and Necessary

Recent studies from the Boston College Center for Retirement Research project that 43 percent of American households are at risk of an insecure retirement.[31] The basic American pension system—Social Security—by itself is insufficient, although it provides



over 90 percent of the retirement income received by low- and moderate-income workers.[32] And in the future, Social Security will provide even less income as replacement for pre-retirement earnings over time, requiring workers to find additional sources of income when they leave the workforce.

The obvious solution is to "scale up" the private pension system. But that system has two structural problems.

The first is coverage. Only about 50 percent of the private-sector workforce has access to work-based retirement plans at any point in their working lives—a percentage that has varied little for decades.[33] This percentage is substantially lower for low- and moderate-income workers who tend not to have the kind of jobs, or the consistent work histories, that are rewarded with plan participation. For example, the percentage of low- to moderate-income workers with access to employer retirement plans decreases dramatically below 50 percent as annual income drops below $40,000 per year.[34]

The second flaw in the current system is income adequacy. Over the last 20 years, the private pension system has shifted from defined benefit plans to defined contribution plans such as 401(k) plans. 401(k) plans put the burden of saving for retirement squarely on the shoulders of workers; employers usually only match worker contributions, if they contribute at all. Workers assume the risk of deciding whether to save, choosing the right amount to save, investing their funds in the right way, and spending down their accounts so they last a lifetime.

These are difficult assignments with no clear right answers that most workers are ill-equipped to handle. Many deal with the uncertainties inherent in 401(k) plans by failing to save at all, or by saving too little and by failing to invest appropriately.[35]

IRAs were created more than 30 years ago for workers without an employer-based plan.[36] However, few Americans actually contribute to IRAs. Most assets currently held in IRAs represent rollovers of accounts from employer-sponsored plans.

IRAs have failed to appeal because many potential savers lack a connection to the financial services marketplace. In turn, the financial services industry hasn't aggressively marketed IRAs to savers with small amounts to invest.

Low- and moderate-income savers have few incentives to save in IRAs. Tax deductions are irrelevant, and IRAs don't offer the matching contributions that help raise participation in work-based plans. The federal government does offer a Saver's Credit, but it is not refundable, so low-income savers with no tax liability do not benefit.

Why America's IRA is the Way Forward

America's IRA is designed to tackle both the coverage and retirement income adequacy problems.

First, America's IRA would give low- and moderate-income workers a well-designed retirement savings vehicle that is the functional equivalent of an employer-based plan using existing IRA products and channels.

Second, America's IRA will include a new government matching structure to provide savings incentives. The matching structure is designed to reward those who consistently save at least three percent of their income a year with substantial income on top of Social Security in retirement.

Benefits and Costs

- America's IRA gives the 62 million low- and moderate-income Americans who may never have an employer-based plan the ability to increase their retirement income significantly by saving just three percent of their income each year.
- The savings incentives in America's IRA—the dollar-for-dollar match and one-time grants—are estimated to cost roughly $40 billion over ten years with a 10 percent participation rate. By comparison, the Saver's Credit, for which only a small percentage of low- and moderate-income workers qualify, delivers only about $1 billion in savings incentives per year or $10 billion over ten years.[37]
- Low- and moderate-income workers can save more

than two times their salary, which, if converted into an annuity, could replace about an additional 20 percent of their pre-retirement income.

Questions and Answers about America's IRA

What is the purpose of America's IRA?

Many low- and moderate-income workers are at risk of financial insecurity in retirement because they are excluded from employer-based plans.[38] This risk will only increase in the future as Social Security provides less replacement income.[39]

How is America's IRA different from the traditional IRA?

In many ways, it's not. It's the same IRA available to everyone. But it has some extra features designed to replicate the benefits (and avoid the deterrents) to saving found in work-based plans:

- Matching contributions from the federal government—a dollar-for-dollar match for those earning $40,000 or less and a partial match for those earning between $40,000 and $50,000.
- A simple design—just two basic investment choices.
- Easy to administer—matching contributions are delivered through the income tax system directly to accounts.

What are the primary benefits of America's IRA?

America's IRA was designed with successful savings outcomes in mind. Those who participate have the opportunity to achieve an additional layer of retirement income on top of Social Security.

- Low- and moderate-income workers can save more than two times their salary, which, if annuitized, corresponds to replacement income of about 20 percent.
- Added to Social Security benefits, America's IRA could enable low- and moderate-income workers to achieve approximately an 80 percent income replacement rate.

Isn't America's IRA just a gimmick, a giveaway of tax dollars?

No. It just gives low- and moderate-income workers without an employer plan roughly the same financial incentives and savings support services enjoyed by workers with an employer plan. And it does so without creating a new government program.

Isn't there a way to include these workers in employer-based plans instead?

Congress has been trying since 1942 to require employers to include more low- and moderate-income workers in their plans. Pension coverage rates, however, haven't budged for decades. Having a better employer-based pension system is, of course, an important social goal but it is not one likely to be realized soon. In the meantime, workers without a plan need a more effective savings solution than existing IRAs which have failed to generate much new net saving since they were created over thirty years ago.

Will America's IRA jeopardize the employer-based pension system?

Unlikely. Employers with significant numbers of higher-income workers would not be tempted to terminate their current plans in favor of America's IRA for two reasons. First, workers can contribute far less to an IRA ($4,000) than to a 401(k)-type plan ($15,500) and, second, only low- and moderate-income workers are eligible for a matching contribution.

America's IRA will enhance the private pension system where it needs it the most. It will provide an efficient and effective savings vehicle for workers at small employers who have historically been reluctant to offer employer-based plans.

Wouldn't improving the Saver's Credit fix the problem?

The Saver's Credit currently provides a government match for saving by some low- and moderate-income workers. The match is modest and not available unless a worker owes taxes, which many low- and moderate-income workers do not.

Reforming the Saver's Credit to cover more workers and increase the match is a desirable improvement in the current system. It will not, however, replicate the synergies America's IRA is capable of creating between low- and moderate-income workers and the financial services industry.

Why is a private sector delivery system appropriate for America's IRA?

America's IRA harnesses the energy of the private sector to drive savings behavior in the same way 401(k) plans do. America's IRA is designed to grow savings accounts quickly beyond the small balance problem so that the private sector views low- and moderate-income consumers as a valuable market. This gives the private sector an incentive to extend the marketing, educational, and administrative and investment services it now provides to employer-based plans to individual low- and moderate-income savers. In turn, the industry will help persuade more low- and moderate-income workers to become savers.

Alternative proposals call for an intermediary between savers and the private sector. Some advocate expanding the Thrift Savings Plan for federal employees to include workers without an employer plan. Others would require employers to offer payroll deduction services to IRAs for such workers. The first approach requires building a new administrative system that will be costly to taxpayers. The second imposes a new employer mandate that fails to address the disconnect between low- and moderate-income savers and the financial services industry.

America's IRA is ultimately a more effective savings approach through its use of a familiar savings product, simpler investment options, existing private sector services, and expanded government funding for savings incentives to low- and moderate-income savers.

How much might the matching contributions cost?

We estimate that in today's labor force there are 62 million Americans who would be eligible for America's IRA.[40] If 10 percent decide to participate, the cost would be about $40 billion for 10 years.[41]

Why would a private-sector firm be interested in the America's IRA program?

At a 15% take-up rate, America's IRA is estimated to generate $155 billion in new assets under management in 10 years using existing financial products. As accounts grow, America's IRA should be as profitable for most firms as traditional IRAs. The "toaster" plus government match in the first year would help build the account size of America's IRA and increase its profitability.

America's IRA in the Real World

Jason is also born in Jefferson, Iowa, on February 2, 2008. His parents open a Child Account for him, but never contribute. As a result, he has no money for college or to start a business. He works in a small hardware store, and his income is around $20,000 in most years. His employer does not offer a pension plan at work.

When Jason turns 37, he decides that he needs to begin saving. Social Security is his parents' only income in retirement, and he realizes that won't be enough for him. So he opens an America's IRA and is able to save three percent of his income for four out of every five years. He also receives a dollar-for-dollar matching contribution from the government. At age 67, when he is eligible for full Social Security benefits, his account is worth about $134,000 (about $63,000 in today's dollars).[42]

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]

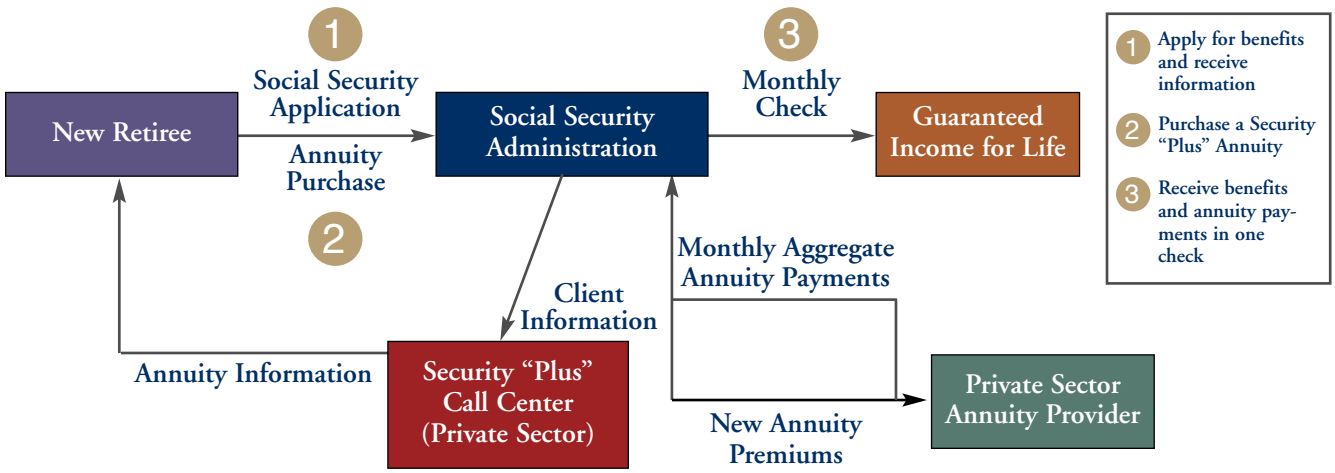
Over the next 20 years, more than 80 million baby boomers will retire. Many of the 76 million eligible for Social Security will need some annuity income beyond those benefits in retirement.

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



- 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.

Conclusion

The fair opportunity to accumulate savings is a primary engine of personal success. If we can meaningfully boost the level of assets held by low- and moderate-income families, we can help bridge the divide between those who have, and those who have not. And we can rebuild the broken pathway to the American Dream for tens of millions of our fellow citizens.

At the same time, boosting the national savings rate can help put the U.S. on a course toward greater prosperity.

The way forward must begin with the recognition that much about the current savings system has not worked. The critically low current levels of personal and national savings compel that conclusion. The government's massive investment through tax relief simply has not reached the segments of our population that need help the most. And we have for too long ignored the necessity of more direct government investment in the future of our people.

We must also bridge the divide between working families and the financial services sector. Sound savings vehicles offer something important to everyone. For consumers, they offer responsible ways to save, invest and own. For industry, they represent an entry point into a potentially massive new market—and an opportunity to make an extraordinary contribution to our national life.

We believe the savings vehicles we propose can serve as the first steps toward a more sensible system of saving, for every American, at every stage of life.

Endnotes

[1] U.S. Department of Commerce, Bureau of Economic Analysis. *Personal Savings Rate.* Last updated 12/22/2006. Available at: http://research.stlouisfed.org/fred2/data/PSAVERT.txt.

[2] Suzanne Nora Johnson, Lisa Mensah and C. Eugene Steuerle. 2006. "Savings in America: Building Opportunities for All." New York, NY: Global Markets Institute at Goldman Sachs. p. 5.

[3] Organisation for Economic Co-operation and Development (OECD). 2006. "Disposable income, saving and net lending/net borrowing." Annual National Accounts Database. 2005 data, our calculations. Available at: http://stats.oecd.org/wbos/default.aspx?dataset-code=SNA_TABLE2.

[4] Johnson et al, p. 7-8.

[5] Johnson et al., p. 9.

[6] Congressional Budget Office. 2004. *The Retirement Prospects of the Baby Boomers.* Economic and Budget Issue Brief. Available at: http://www.cbo.gov/showdoc.cfm?index=5195&sequence=0.

[7] Johnson et al., p. 10.

[8] Wan He, Manisha Sengupta, Victoria A. Velkoff, and Kimberly A. DeBarros. 2005. *65+ in the United States: 2005.* Current Population Reports, P23-209. Washington, DC: US Government Printing Office.

[9] Isaac Shapiro and Joel Friedman. 2006. *New CBO Data Indicate Growth in Long-Term Income Inequality continues.* Washington, DC: Center on Budget and Policy Priorities.

[10] Katharine Bradbury and Jane Katz. 2002. *Are Lifetime Incomes Growing More Unequal? Looking at New Evidence on Family Income Mobility.* Regional Review, Q4 2002:4. Boston, MA: Federal Reserve Bank of Boston. Available at: http://www.bos.frb.org/ec--onomic/nerr/rr2002/q4/issues.pdf.

[11] Williams (2004).

[12] Ibid.

[13] Pell Institute for the Study of Opportunity in Higher Education. 2005. *Indicators of Opportunity in Higher Education.* 2005 Status Report. Washington, DC: Pell Institute for the Study of Opportunity in Higher Education.. Available at: http://www.pellinstitute.org/files/6_Indicators.pdf.

[14] Johnson et al., 20-21.

[15] Perun (2006).

[16] The match would be available to families who earn less than 200 percent of the federal poverty line, following the same guidelines that apply to the Earned Income Tax Credit (EITC).

[17] These accounts are created under uniform statutes regarding gifts or transfers to minors.

[18] The "kiddie" tax, found in Internal Revenue Code §1(g), is designed to discourage higher-income taxpayers from transferring substantial assets to children to take advantage of their lower tax rates.

[19] Child accounts originated in theories of asset-based welfare policy advanced by Michael Sherraden of Washington University in St. Louis. Sherraden proposed a new theory of savings behavior based on two interactive principles: most individuals do not save without having structures to facilitate savings, and the process of saving and accumulating assets positively changes behavior.

[20] Endowment figures are increased annually for inflation. In addition, the UK has recently announced plans to make another round of contributions when children attain age seven.

[21] Kempson et al. (2006).

[22] The America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act of 2005 (S.868, H.R. 1767).

[23] This example assumes three percent inflation during this 18-year period.

[24] It is possible that Home Accounts could contain eligibility criteria to ensure that their benefits flow to truly low- and moderate-income families.

[25] Households earning under $75,000 per year or single filers earning under $50,000 would be eligible for matching contributions.

[26] Johnson et al.,p. 11.

[27] Mills et al. (2004).

[28] Telephone interview with Ben Mangan, President and CEO of the Earned Assets Resource Network, January 28, 2007.

[29] Joint Center for Housing Studies (2006).

[30] Ibid.

[31] Center for Retirement Research 2006. *Retirements at Risk: A New National Retirement Risk Index.* Chestnut Hill, MA: Boston College, Center for Retirement Research. Available at: http://www.bc.edu/centers/crr/special_pubs/NRRI.pdf.

[32] In 2005, the bottom quintile received 91.3 percent of its retirement income from Social Security benefits; the next quintile received 87.5 percent. Source: Employee Benefit Research Institute. 2006. *Income Statistics of the Population Ages 55 and Over.* EBRI Databook on Employee Benefits. Washington, DC: Employee Benefit Research Institute.

[33] Munnell and Perun (2006).

[34] Ibid.

[35] Alicia Munnell and Annika Sunden. 2004. *Coming Up Short; The Challenge of 401(k) Plans.* Washington, DC: Brookings Institution Press.

[36] America's IRA is an IRA expressly dedicated to workers without a plan. It resembles but is not identical to an IRA available to workers through an employer-sponsored plans such as a Simplified Employee Pension (SEP) or SIMPLE IRA.

[37] William G. Gale, J. Mark Iwry, and Peter R. Orszag. 2004. *Improving the Saver's Credit.* Policy Brief #135. Washington, DC: The Brookings Institution.

[38] Munnell and Perun, op. cit.

[39] Alicia Munnell. 2003. *The Declining Role of Social Security.* Just the Facts on Retirement Issues, no. 6. Chestnut Hill, MA: Boston College, Center for Retirement.

[40] These statistics represent the total number of workers based on information provided in Table NC8, "Pension plan coverage of workers, by selected characteristics, sex, race and Hispanic origin and poverty status: 2001" from the March 2002, Current Population Survey published by the US Census Bureau. Available at: http://pubdb3.census.gov/macro/032002/noncashnc8001.htm. These numbers were adjusted for inclusion of minors and retirees in these data.

[41] This estimate assumes that these workers contribute three percent of their salary for four out of five years while working.

[42] This example assumes an inflation rate of 2.5 percent, net investment returns (net of fees) of 5 percent, and a real rate of return of 2.5 percent.

[43] An annuity is an investment product purchased from an insurance company that provides guaranteed income for life. It protects retirees against longevity risk (the risk of living longer than their savings) as well as investment risk (the risk of losing savings in a market downturn).

[44] David L. Wray, 2005. *Testimony before the ERISA Advisory Council Working Group on Retirement Plan Distributions and Options.* Available at: http://www.psca.org/WASH/PDF/july8-2005testimony.pdf. Last accessed January 25, 2007.

[45] Annuity estimates are for a single life annuity and come from the TSP calculator which currently uses an annuity interest rate index of 5.25 percent. Available at: http://calc.tsp.gov/annuityCalculators/calcAnnuitySingle.cfm.

Technical Appendix

This appendix describes the modeling assumptions and logic that were used to develop the four recommendations in "Savings for Life," and presents a more detailed analysis of savings behavior, government outlays, and market size for each product.

Child Accounts

The Child Accounts model projects individual account behavior over 18 years to derive market size and government outlays over time.

Using Census data regarding population growth projections and the distribution of family income, the 4 million children born in the US each year are divided into three income categories (low-, middle-, and high-income) and three types of savings patterns: non-savers, "moderate savers" who make modest contributions, and "aggressive savers" who tend to maximize account values.

Distribution of Families by Income and Savings Behavior

	Income Range	% of All Families	Non-Savers	Moderate Savers	Aggressive Savers
Low-Income Families (Match-Eligible)	Under $40,000	35%	80%	15%	5%
Middle-Income Families	$40,000-$100,000	45%	70%	25%	5%
High-Income Families	Over $100,000	20%	60%	30%	10%

Based on these behavioral assumptions, each of these nine groups is tracked for 18 years of saving, assuming consistent behavior: each group saves or does not save, accounts held by low-income families receive a government match on their savings, and each account receives investment income during the year. For modeling purposes, a 1.5% fee is deducted from the account at the end of each year and transferred to the account provider to cover both account maintenance and applicable fees of the underlying investments. This replicates the Child Trust Fund policy in the United Kingdom, which has a 1.5% cap on variable fees and no fixed fees.

All accounts are invested in a lifecycle fund that is re-allocated toward bonds and cash as the child ages, resulting in a projected 8% rate of return until age 6 and decreasing thereafter, reaching a 4.6% return at age 18. Individual account growth is not adjusted for inflation. However, present-value calculations are offered.

Summary of Results

Individual Account Growth

	Monthly Contributions	Year 5	Year 10	Year 18
Non-Savers	$0	$695	$934	$1,295
Low-Income Moderate Savers	$20, matched 1:1	$3,319	$7,214	$14,437
Middle-Income Moderate Savers	$50	$3,791	$8,301	$16,388
Middle-Income Aggressive Savers	$100	$7,586	$19,370	$42,966
High-Income Aggressive Savers	$167 ($2,000/year)	$11,224	$26,772	$55,771

Assets Under Management

	Year 1	Year 5	Year 10	Year 18
First-Year Cohort Accounts (billions)	$2.8	$8.4	$17.1	$32.8
Cumulative Accounts (billions)	$2.8	$27.8	$97.3	$316.3
Number of Accounts (millions)	4.0	20.5	41.7	77.5
Average Account Balance	$686	$1,359	$2,331	$4,081

Government Outlays (Billions)

	Year 1	Year 5	Year 10	Year 18
Annual Endowment	$2.000	$2.062	$2.143	$2.279
Annual Match	$0.093	$0.530	$1.095	$2.046
Cumulative Outlays	$2.093	$11.709	$26.597	$57.344

Conclusions

This analysis reveals that depending on contribution levels and investment performance, Child Accounts can grow to over $1,200 without further contributions ($750 in today's dollars), or as large as $55,000 ($33,000 in today's dollars) if contributions are maximized. They represent a market of approximately $100 billion within ten years, with average account balances over $2,000. The government outlay over ten years is approximately $27 billion. Each year as accounts mature, that cohort's total government contributions are leveraged more than eight times by private contributions and investment income.

Home Accounts

The Home Accounts model projects savings and home purchases of prospective homebuyers as well as the market size and government outlays for an entire market of down payment savers. Home Accounts are targeted to support households with incomes under $75,000 (and individuals earning less than $50,000) who do not currently own homes.

The model focuses on savers in the bottom four income quintiles.[1] Each of these four quintiles is assigned a uniform savings pattern, with annual savings ranging from $850 for the bottom-quintile savers to $5,000 for fourth-quintile savers. In the modest scenario modeled for Home Accounts, each saver makes deposits and receives a 50% government match (up to $5,000) on savings for three or four years before potentially purchasing a home. Modest takeup assumptions (2-4%) grow over time, and taking attrition into account, at least 75% of Home Accounts savers are projected to eventually buy homes.

At the end of the savings period, account assets are assumed to be used for a down payment and closing costs toward the purchase of a home. Metrics for each quintile's mortgage eligibility—based both on annual household income and the accumulated down payment of 5 or 10%—are used to determine a home price that would be considered affordable for that buyer. Affordability is based on a total housing cost—mortgage payments, property tax, and insurance—of no more than 45% of income for households in the bottom two quintiles and 30% of income for households in the third and fourth quintiles. All home purchases are projected to be 30-year fixed mortgages with an interest rate of 7.07%. In the aggregate, these home purchases constitute new mortgage activity.

Assumptions

	Quintile 1	Quintile 2	Quintile 3	Quintile 4
Mean Household Income	$10,294	$25,865	$43,293	$68,040
Annual Savings	$850	$1,500	$3,000	$5,000
Years of Saving	3	4	4	4
Home Purchase Price	$52,464	$128,571	$141,667	$208,333

[1] Since household incomes in the fourth quintile approach $85,000, takeup rates have been adjusted to account for the 40% of households in this quintile that would not be eligible for a match.

Summary of Results

Home Account Assets Under Management		
	Year 5	Year 10
Active Home Accounts *(millions)*	4.5	7.5
New account deposits *(billions)*	$15.4	$25.5
Total account deposits *(billions)*	$35.2	$70.1

New Mortgage Activity		
	Year 5	Year 10
New homebuyers, cumulative *(millions)*	0.60	3.88
Annual mortgages *(billions)*	$58.6	$93.7
Cumulative mortgages *(billions)*	$63.9	$456.6

Government Outlays *(Billions)*		
	Year 5	Year 10
Annual cost to government	$2.4	$4.2
Cumulative cost to government	$10.4	$27.9

Conclusions

Given conservative takeup of this product and modest savings by prospective homebuyers, Home Accounts can create approximately four million new homeowners over ten years. These modest savings accounts leverage $64 billion in mortgages after five years and $457 billion after ten years, at a cumulative government outlay of $28 billion over a ten-year period.

America's IRA

The America's IRA model projects both the asset accumulation of one typical low-income saver and the market size and government outlays for an entire market of savers. The target market for America's IRA is the approximately 62 million American workers who do not have access to employer-based retirement plans in any given year, the majority of whom have annual incomes below $50,000.[2]

Total market size and government outlay estimates are derived from takeup assumptions across a representative portfolio of potential savers whose incomes range from $5,000 to $50,000 and who are currently excluded from employer plans. Workers in this income range are divided into cohorts of $2,500 each, with participating savers assumed to have identical savings behavior: they each contribute 3% of income during four out of every five years.

In order to understand the dynamics of individual account growth and the effects of government contributions on these accounts, a single, representative account is constructed for a saver whose starting income is $20,000. This case study is tracked for 30 years based on an income trajectory that increases over time and then declines as the saver ages, with average real wage growth at approximately 1% per year over this time period.[3] The annual inflation rate is assumed to be 2.5%. Yearly contributions are incorporated into the model, along with the partial first-year government subsidy and the 100% government match on contributions that this saver would receive. Investment returns are projected to be 5% net of fees, resulting in a 2.5% net annual return. This rate of return is conservative for a portfolio with equity exposure, but America's IRA is a product designed to operate as either a lifecycle investment account or a principal-protected product.

[2] These statistics represent the total number of workers based on information provided in Table NC8, "Pension plan coverage of workers, by selected characteristics, sex, race and Hispanic origin and poverty status: 2001" from the March 2002, Current Population Survey published by the US Census Bureau. Available at: http://pubdb3.census.gov/macro/032002/noncashnc8_001.htm. These numbers were adjusted for inclusion of minors and retirees in these data.

[3] Urban Institute calculations based on Eric Toder et al. "Modeling Income in the Near Term: Revised Projections of Retirement Income Through 2020 for the 1931-1960 Birth Cohorts." Final Report. Washington, DC: The Urban Institute, June 2002.

To consider whether America's IRA would demonstrate sufficient asset accumulation to achieve a level of retirement adequacy, the end balance after 30 years of projected saving was assumed to be converted into an immediate life annuity using the annuity estimator of the federal Thrift Savings Plan (TSP). For an annuity purchase at age 67, this calculator used a 5.25% annuity interest rate, which means that each year, total annuity payments received would equal approximately 9.25% of the annuity purchase. The value of this annuity, coupled with projected Social Security benefits based on lifetime earnings, was then compared to an adequacy definition of 80% of pre-retirement income.

Summary of Results

Account Growth for a $20,000 Worker Starting At Age 37

	Age 37	Age 42	Age 47	Age 57	Age 67
Annual Income	**$20,000**	**$27,948**	**$37,264**	**$52,741**	**$59,533**
Annual Contribution	$615	$780	$1,086	$1,553	$1,762
Government Matching Contribution	$615	$780	$1,086	$1,553	$1,762
Investment Earnings	$87	$1,161	$4,637	$23,606	$70,417
End-of-Year Balance	$1,817	$7,277	$17,849	$59,235	$133,691

Assets Under Management *(Billions)*		
	Year 10	**Year 30**
10% Uptake	$103.6	$770.8
15% Uptake	$155.4	$1,156.2
20% Uptake	$207.2	$1,541.6

Cumulative Government Outlays *(Billions)*		
	Year 10	**Year 30**
10% Uptake	**$42.5**	**$267.7**
15% Uptake	**$63.7**	**$401.5**
20% Uptake	**$84.9**	**$535.4**

Conclusions

This analysis reveals that persistent, matched savings by an uncovered employee earning $20,000 could yield an account balance of over $130,000 after 30 years ($63,000 in today's dollars). As an annuity, this could add approximately $485 in monthly income for life, in today's dollars—or more than 20% of that worker's pre-retirement income. If 15% of Americans in the target market become savers in America's IRA, this market could grow to $155 billion over ten years. At this rate, the government outlay over ten years is approximately $64 billion.

Security "Plus" Annuities

The Security "Plus" Annuities model projects both the potential annuity purchases of new retirees and the market size for an entire market of new annuitants. The target market for Security "Plus" is the approximately 80 million Baby Boomers who will be retiring between 2008 and 2030. Although expected to grow as Baby Boomers retire, the immediate life annuities market is currently small with annual sales of approximately $6 billion in 2004.[4]

[4] Kaja Whitehouse. "Annuities, Meet 401(k)s." The Wall Street Journal, August 15, 2005.

Total market size is derived from takeup assumptions across a market of potential new retirees. There will be approximately 3.5 million Baby Boomers retiring on average each year, of which about 90% are eligible to receive Social Security benefits.[5] Based on takeup and average purchase amount assumptions for these 3.15 million new retirees, the model projects annual and cumulative market sizes. Each new retiree has only one opportunity to purchase a Security "Plus" annuity— during the first year following initial receipt of Social Security benefits— and annuity purchases are limited to $100,000 per retiree.

In this model, Security "Plus" annuitants receive monthly, lifetime benefits in an immediate life annuity calculated using the annuity estimator of the federal Thrift Savings Plan (TSP).[6] This annuity calculator used a 5.25% annuity interest rate, which means that for an annuity purchased at age 67, each year total payments received would equal approximately 9.25% of the annuity purchase. Monthly benefits would be lower in the case of joint-and-survivor annuities and other types of annuity products that could be made available.

Summary of Results

Individual Annuity Payments Under Security "Plus"				
			Additional Replacement Income	
Annuity Purchase	**Yearly Benefit**	**Monthly Benefit**	**$20,000 Worker**	**$40,000 Worker**
$20,000	$1,848	$154	9.2%	4.6%
$50,000	$4,620	$385	23.1%	11.6%
$100,000	$9,240	$770	46.2%	23.1%

Market Size for Security "Plus" Annuities *(Billions)*				
	5% Takeup		10% Takeup	
Annuity Purchase	**Annual New Market**	**Cumulative Market**	**Annual New Market**	**Cumulative Market**
$20,000	$3.5	$76.0	$6.9	$152.0
$50,000	$8.6	$190.0	$17.2	$380.0

Conclusions

This analysis reveals that depending on accumulated savings and today's annuity purchase rates, a new retiree is able to purchase an additional lifelong monthly benefit of up to approximately $770 through Security "Plus" annuities. For a worker whose annual earnings while working were approximately $40,000, this benefit is able to replace 23% of pre-retirement income. Even if only 5% of eligible retirees purchase a Security "Plus" annuity, assuming an average annuity purchase amount of $50,000, this $8 billion annual market would be larger than today's annuities market, and would become a market of over $190 billion between 2008 and 2030.

[5] These projections are based on data obtained from the Office of the Chief Actuary, Social Security Administration, in a personal communication dated January 17, 2007.

[6] Annuity estimates are for a single life annuity. Available at: http://calc.tsp.gov/annuityCalculators/calcAnnuitySingle.cfm

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