



Now is the Time to Add Retirement Accounts to Social Security: The Guaranteed Retirement Account Proposal

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Despite billions in tax breaks to incentivize retirement savings, almost half of the American workforce does not have a retirement plan.¹ Without safe, effective accounts to save consistently for retirement, older workers face the increasing likelihood of experiencing downward mobility in retirement.

Rather than relying on families and social spending to provide for the growing numbers of vulnerable seniors, we need comprehensive retirement reform to ensure retirement income security. This includes creation of Guaranteed Retirement Accounts (GRAs) added on to Social Security.

A GRA is a mandated, professionally-managed retirement account – a hybrid between a defined benefit pension and a 401(k)-type defined contribution plan. GRAs guarantee principal and an annual rate of return and pay annuities. Combined with a change in the tax code to switch ineffective and regressive tax deductions for retirement savings to universal tax credits, GRAs give every worker the opportunity to retire with dignity.

THE PROBLEM: INADEQUATE RETIREMENT INCOME

For most of the last century, American retirement income policy supported a combination of programs—Social Security, federal, and state tax subsidies for traditional defined benefit pensions and for voluntary personal retirement accounts—that enabled people to choose to retire and still maintain their living standards, while reducing old-age poverty.

But this system is breaking down. If current trends continue, an increasing number of workers, including middle-class workers, will face downward mobility in retirement.

Between 2013 and 2022, the number of poor or near-poor 65 year olds will increase by 146

percent. 4.3 million of the 18 million workers aged 55-64 in 2012 will be poor or near poor at age 65.²

The bleak future for retirement is mostly due to a decrease in the number of workers with an employer-sponsored retirement plan and the prevalence of inadequate 401(k)-type plans.

Fewer employers are sponsoring retirement plans for fewer employees. From 2001 to 2012, the share of workers without an employer-sponsored plan, including both traditional pensions and 401(k) type plans,³ rose from 39 percent to 47 percent.⁴

In the most populous states, the share of uncovered workers exceeds the national average. Fifty-seven percent of New York City workers are not covered at work, followed by 56 percent for Florida, 52 percent for California and Texas, and 48 percent in New York State as of 2012.⁵

If workers do have a retirement plan through their employer, these plans have shifted from defined benefit (DB) plans, where workers are guaranteed a set payment for life based on years of service and salary, to defined contribution (DC) or individual account 401(k)-type plans. DC plans shift all the risks and cost of retirement onto the shoulders of workers: they charge exorbitant fees that eat away at returns, require workers to choose from a bewildering and opaque menu of investment options, may be exhausted before the end of a worker's life, and — as the Great Recession has shown — are vulnerable to huge losses in a bear market.

The resulting erosion of retirement savings is lowering the living standards of millions of retirees and threatens to leave the next generation of workers and governments, especially state and local governments, to shoulder the costs of caring for millions of vulnerable and poor elderly Americans.⁶

Annuities Enhance Retiree Satisfaction

Not having a lifelong pension to supplement Social Security takes its toll on Americans through increased anxiety. Surprisingly, this fear of outliving one's retirement savings reaches those who do have retirement benefits, namely defined contribution plans. Unlike annuities, which guarantee a stream of income for life, DC plans burden retirees with the task of ensuring that their lump sum of retirement savings doesn't run out before the end of their lives. Not surprisingly, this causes those with DC plans to report lower levels of well-being.

Let's compare two 65-year-olds who are alike in every way except in the form of their \$250,000 retirement plan. One retiree has a \$250,000 IRA that he has to manage to last the rest of his life. The other has a pension valued at \$250,000 that pays \$1,500/month for the rest of his life no matter how long he lives. Who is happier? Hands down, the research shows it is the retiree with the lifelong guaranteed annuity. Economists Steve Nyce and Billie Jean Quade find in "Annuities and Retirement Happiness" that when comparing retirees with similar levels of health and wealth, those with annuitized incomes are the happiest.

Annuities help retirees with less wealth and those in poor health feel more satisfied with their lives. Nyce and Quade updated, expanded, and confirmed earlier findings

from Rand and Boston College ⁷ that secure lifetime benefits caused less anxiety among older people than lump sums. Economists Constantijn Panis from the Rand Institute and Kevin Bender and Natalia Jivan from the Center for Retirement Research in 2000 and 2005 find that retirees who are most satisfied tend to be older, have traditional pension annuities, and had the flexibility to choose when to retire. In 2003, Panis found annuities provide more satisfaction than equivalently valued lump sums.⁸ Bender and Jivan conclude that while income and wealth increase overall well-being, the effect is relatively small compared to having guaranteed income for life. Having a defined benefit plan that provides a lifetime annuity has a positive impact on the well-being of retirees, compared to having no pension or just a defined contribution plan.⁹

The Employee Benefit Research Institute's ongoing survey about retirement confidence consistently shows that having a retirement plan is the most important factor in whether an older worker is confident they will have enough money and security in retirement. Bloomberg News journalist Christopher Flavelle reports on a survey from Bankrate which suggests retirement anxiety is the new "class divide." People who earn more than \$75,000 per year are three times more confident that they are saving enough compared to the bottom 80 percent.¹⁰

THE SOLUTION: GUARANTEED RETIREMENT ACCOUNTS

Workers need Social Security supplements to live a dignified retirement. The average Social Security benefit is only \$12,100 per year. Despite its modest benefits, Social Security provides over 80 percent of income for 40 percent of older Americans.¹¹ In addition to strengthening the Social Security system by updating minimum benefits and reinstating the fixed minimum benefit provision to ensure the primary insurance amount is equal to the federal poverty level,¹² the system also needs supplementary accounts that pay benefits on top of Social Security. Known as Guaranteed Retirement Accounts (GRAs), these savings vehicles would invest workers' contributions in a safe, low-fee account that earns a secure, modest, guaranteed rate of return and preserves savings for retirement benefits paid out in annuities.

Qualities of an Effective Retirement System

The GRA proposal is rooted in the principles that retirement is both an individual decision and a social good. Beginning with the creation of Social Security in 1935 and the subsequent growth of our employer-provided retirement system, the United States has supported the goal of ensuring that all workers, regardless of income, can retire with adequate income.

Retirement USA, a Washington, DC-based advocacy group representing workers and retirees, established 12 principles necessary to provide a solid policy foundation for retirement reform. These include universal coverage, secure retirement, adequate income, shared responsibility, required contributions, pooled assets, payouts at

retirement, lifetime payouts, portable benefits, voluntary savings, efficient and transparent administration and effective oversight. In 2009, SCEPA's proposal for Guaranteed Retirement Accounts was the only reform measure certified by R-USA as fulfilling each of these principles.¹³

They were not alone in recognizing the quality of GRAs. The *New York Times* included the GRA in its 2008 "Year in Ideas," that looks back on the year's most innovative and ingenious ideas.¹⁴ The 2010 annual report of the White House Task Force on the Middle Class, headed by Vice President Biden, cited GRAs as an option to help American families save for retirement. The report states, "These accounts would allow workers to be sure that the funds invested in them will grow steadily without the risk of a market collapse."¹⁵

The policy challenge is to expand access to individual, pre-funded retirement plans and address the failures in the existing system by making a new retirement savings vehicle that meets three key criteria for retirement income security:

1. Help workers make adequate retirement account contributions and prevent early withdrawals
2. Provide low-cost, quality investment vehicles that are professionally managed and help shield individual workers from investment and market risks
3. Provide a lifetime guaranteed stream of income at retirement

The federal Guaranteed Retirement Account addresses each of these goals, making it the practical solution to the retirement crisis.

How the GRA Works

Guaranteed Retirement Accounts can be implemented on either the state or federal level.

Federal GRAs would provide every American with a personal retirement account in addition to Social Security. Accounts would be created and administered by the Social Security Administration, overseen by an independent board of trustees and managed by professional fund managers.

State GRAs would offer personal retirement accounts to all workers by allowing private sector workers or employers to voluntarily open an account in a state-level public retirement fund (State GRA's would be an option under exchanges created by Secure Choice Boards). These funds would be overseen by an independent board of trustees and managed by professional fund managers.

As supplemental accounts to Social Security, GRAs support the three pillars of safe and efficient retirement savings instruments:

1. **Accumulation:** To accumulate adequate pension income, GRAs include mandates that workers and employers contribute at least 5 percent of pay above Social Security. Because day-to-day challenges don't always support consistent long-term planning, automatic payroll deductions work best.
2. **Investment:** To support growth without exposure to unnecessary risk, an account must provide moderate returns at 2 to 3 percent above inflation (after the deduction of investment and management fees).
3. **Lifetime Payout:** To ensure that retirees do not outlive their retirement savings, funds would be paid out at retirement in the form of an annuity, or lifetime income stream.

Structure & Implementation: The following list provides an overview of the possible routes to implementing GRAs at the state or federal level.

Cash Balance Plans: GRAs are similar to cash balance plans, or a hybrid between a traditional defined benefit pension and a 401(k)-style defined contribution plan. This plan type is not new. Many corporate, educational institutions and public sector workers have versions of mandatory retirement accounts. TIAA-CREF, one of the largest non-profit investment firms in the country, has offered this type of fund for over 80 years. The TIAA Traditional Annuity guarantees principal and pays a guaranteed minimum interest rate during the accumulation phase.

Cost: Implementation of the GRA would cost very little, as it takes advantage of existing infrastructure. There would only be minimal start-up costs for employers and the state to implement the new system.

Employee and Employer Contributions: The recommended contribution is 5 percent of pay, with deposits deducted directly from an employee's check similar to FICA taxes. Employers could contribute a portion of this percentage on behalf of each employee. The 5 percent savings rate is calculated to offer middle-class workers, coupled with Social Security, the recommended 70 percent replacement rate after a standard of 44 years of work. Beyond this threshold,

which seeks to maintain pre-retirement standards of living, workers could contribute more according to their individual choice.

Fund Managers: These funds would be managed by commercial money managers, similar to regular defined benefit pension funds. Contributions would be pooled and invested with an emphasis on prudent, low-risk, long-term gains. This would shield workers from the retail market's high fees and short-term investment choices.

Leakage Prevention: In hard times, people are tempted to dip into their nest egg. These kinds of leakages erode one's retirement income and, with it, security and their standard of living in old age. To protect retirement income from day-to-day financial pressures and thus preserve it, the GRA does not allow for hardship withdrawals.

Performance: State GRAs would take advantage of existing state pension infrastructure. States, through their employee pension plans, sponsor not-for-

profit financial institutions that consistently receive the highest returns for the least cost. Public pension plans outperformed 401(k) plans or IRA accounts by 20 to 40 percent over the last 30 years. These funds use their bargaining power to lower fees, and public pension fund traders have a longer-term view, which stabilizes markets and protects individuals from swings in asset prices.

Portability: When people change jobs, they often cash out their pensions or retirement accounts instead of transferring their accrued savings elsewhere. A benefit of the GRA system is its portability, allowing workers to continue investing in the same account as they move from job to job.

Rate of Return: The principal in each GRA would be guaranteed. Returns above the principal guarantee would be adjusted for inflation and earn a rate of return determined by the board according to overall economic conditions. Based on past performance, the return would likely range from 1 to 4 percent above inflation.

Revenue-Neutral Tax Credits to Provide Every Worker with Retirement Savings

Most people's GRA contributions will be paid by the federal government with a \$600 tax credit through a revenue-neutral change in the tax code.

Federal and state governments direct \$100 billion to \$140 billion (with the range dependent on methodology used to estimate the revenue losses) of public resources to incentivize retirement savings. Because these tax breaks are highly regressive, taxpayer dollars end up

benefiting higher-income individuals who are likely to save for retirement without government subsidies while workers with modest incomes risk poverty in old age due to inadequate retirement savings.¹⁶

The failure of these tax expenditures stems from using tax deferrals to foster retirement savings. A simple, revenue-neutral solution – switching the tax deferral to a refundable tax credit – would provide

each saver with a tax credit that can be deposited directly into a GRA.

Using conservative estimates, if retirement tax deferrals had been converted to refundable credits in 2014, workers would have received up to \$819 each: the sum of the federal tax expenditure per worker (\$647) and the state tax expenditure per worker (\$172). Nationally, 87.8 million workers without access to a retirement plan would have received \$647 from the federal

government. At the state level, 115.8 million workers not participating in a retirement plan and living in states with an income tax would have received an additional \$172 on average from the state credit.

If \$800 were automatically deposited in each worker's GRA every year starting at age 25, the retirement account balance would be over \$67,000 when he or she reaches 65 years old.¹⁷

GRAS vs. OTHER POLICY SOLUTIONS

In recognition of the oncoming retirement crisis, numerous policy proposals have been put forth at both the state and federal levels. In 2009, the Obama Administration proposed an IRA that did not advance in Congress. Meanwhile, over 14 state governments are considering various types of retirement plans for private sector workers.

Momentum and innovation to solve inadequate retirement plan coverage at the state level indicates the need for a federal solution. As in past policy making, such as Social Security, state innovation often informs and shapes federal programs.

Obama Administration's Auto IRA

This proposal aims to benefit workers without access to a retirement plan at work. It would require employers that do not already offer a retirement plan to enroll their employees in a direct-deposit IRA account compatible with existing direct-deposit payroll systems.¹⁸ 3 percent of each paycheck would be deposited into a Roth IRA, in which contributions are made with

after-tax dollars. Withdrawals from the Roth IRA would be tax-free for account holders age 59.5, or older if the account was held for at least five years.¹⁹

Obama's Auto IRA initiative also proposed to expand retirement savings incentives for working families by modifying the existing Saver's Credit to provide a one-time 50 percent match on the first \$1,000 of retirement savings for families that earn less than \$65,000. The credit would have been fully refundable to ensure that savings incentives are fair to all workers."²⁰

Advantages:

- Those who make contributions to Auto IRA accounts may be eligible to benefit from the Saver's Credit, which is a contribution for low- and middle-income workers who save for retirement. In this case, the government would pay part of the cost of the saver's contribution to the IRA.
- Automatic enrollment is an effective means for workers to save for retirement, and this proposal attempts

to bring more workers into retirement savings programs.

Disadvantages:

- The proposal did not advance in Congress.
- Employees can opt-out and withdraw from accounts before retirement, both of which result in sub-optimal retirement savings.
- The Saver's Credit requires over \$50 billion if it is refundable and income limits are increased.²¹

Obama Administration's MyRA

After the Obama Administration's original Auto IRA was rejected, the United States Treasury developed a retirement account plan entitled "myRA." It is a type of Roth IRA, where individual savers can contribute up to \$5,500 annually into myRA accounts.

These contributions are then invested in U.S. securities, which averaged an annual return of 3.19 percent over the ten-year period ending December 2014.²² Since a government bond guarantees a saver cannot lose money, the return will not be high.²³ Employers are not required to directly administer or contribute to the accounts, only to facilitate them by deducting contributions from paychecks through direct deposit.

To avoid competition with financial-services firms, the U.S. Treasury directly administers the myRA accounts (in cooperation with a private-sector bank) when they are small and turns them over to private sector IRAs once the account balance is greater than the \$15,000 maximum amount, or after thirty years.²⁴

Advantages:

- The myRA accounts aim to increase retirement savings.
- People contributing to myRAs may be eligible for the saver's credit.
- Workers are shielded from investment and market risks by investing in U.S. treasuries.

Disadvantages:

- myRA accounts are voluntary, for both the employer to offer and the employee to participate in. Unless there is auto-enrollment, people are not likely to enroll, especially low- and middle-income taxpayers.²⁵
- The maximum contribution cap of \$15,000 may inhibit more savings, and the commercial IRAs to which they will be converted have high fees.
- The return rate on U.S. securities is secure but low, and may not beat inflation.²⁶
- There are no provisions for annuities.
- Overall, myRA accounts are a first step to expand retirement savings, but without automatic enrollment and given the low cap, will not be an effective way to increase savings enough to fund lifelong benefits.

The Secure Choice Retirement Savings Program

Secure Choice Pensions (SCP) are state-level proposals aimed to provide retirement security for workers by requiring certain employers to make payroll deductions on behalf of their employees for savings in Roth IRAs.²⁷ A handful of states - Illinois,

Massachusetts, Oregon, California, Maryland, and Connecticut - are at various stages of researching and implementing retirement automatic payroll deduction plans. Participants would be fully vested in their accrued benefits immediately, and the amounts contributed plus earnings would be overseen by an independent board of trustees who administer the plan.

Advantages:

- SCPs are being proposed and considered across the country²⁸ and help millions of private sector workers without access to any kind of pension plan.
- SCPs could provide guaranteed minimum retirement income (with the possibility for additional earnings) and a life annuity benefit, although none of the current Secure Choice plans currently do so.
- If participants were provided with a pooled investment option, they could get higher returns with less risk because of the advantages of economies of scale in obtaining low fees and low risk from diversification.

Disadvantages:

- In all of the Secure Choice models, as with the myRA plan, workers can opt-out of an individual account, and are likely to do so if they require short-term funds for daily financial struggles.
- None of the models have a presumed annuity payout.

AFSCME Retirement Program

The State Supplemental Social Security Act proposed by the American Federation of State, County and Municipal Employees (AFSCME) proposes a mandated and advanced-funded supplement to Social Security managed by the state.

This proposal would have states raise payroll taxes to pay for a benefit computed using the Social Security actuarial methodology. Employees must have 40 quarters of covered service to qualify for any benefit, and if they move out of state, they will have both their and their employer's contributions returned after age 62.²⁹

Advantages:

- It is an ambitious proposal that entails the federal government eventually mandating a supplement to Social Security.

Disadvantages:

- The proposal received little support in state legislatures, which found Secure Choice proposals that do not raise taxes more popular.
- Despite being the purest form of filling the void left by the erosion of defined benefit plans, the corporate business structure no longer supports the defined benefit model.

AARP's "Work and Save"

AARP's "Work and Save" proposal aims to support businesses in creating private retirement savings accounts for employees based on the model of 529-plans. These plans would be authorized by the state, run by the private sector, and professionally managed.

Work and Save seeks to support five main principles of a retirement program: financial freedom, voluntary participation, portability, saving taxpayer dollars, and no risk.

The Work and Save program allows money saved by participants to travel with the owner, provides tax advantages to enrollees, is available to everyone – including small businesses and low-income employees - and has a low cost to taxpayers and participants.

Advantages:

- The Work and Save proposal has support from a variety of aging, human services, business and labor groups across the country.
- More than a dozen states have considered legislation of this kind. Massachusetts, California and Oregon were the first to enact legislation.
- AARP has presented surveys showing support for such a plan among a majority of workers who do not have access to any kind of workplace retirement plan.

Disadvantages:

- The program is voluntary, which leaves it vulnerable to a lack of participation, withdrawals and impracticality for lower income workers.

Working Longer

People facing inadequate retirement income often rely on working longer as a solution. However, they also face an increasingly unfriendly job market as they get older. Employers often prefer hiring younger workers, leaving older workers to face longer periods of unemployment. Additionally, poor health, either one's own or a spouse's, make it impossible to work. Altogether, older workers expecting to work longer often end up retiring earlier than planned.

According to EBRI's confidence survey, workers expect to retire at age 65.³⁰ However, the average age of retirement is much lower, about age 62.³¹ From 2010 to 2015 the number of retirees who said they retired earlier than expected went up 9 percent. This is because of poor health – affecting themselves or their spouse – or because they were laid off, not promoted, or not trained.³²

Most of those faced with the reality of not being able to retire due to inadequate savings report that they plan to work longer or "die at their desk." The unpleasant realities of the labor market for older workers do not justify dependence on employment until 70 years-old to maintain living standards into retirement. This includes the facts that many older people can't work because they care for fragile

spouses or family members, high rates of long-term unemployment and falling wages for older workers, the persistence of age discrimination, and the increasing pace and technical content of work.

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After workers reach ages 55-69, they experience a decline in earnings regardless of education, as they are overlooked for promotions and on-the-job training. This reminds us that work in old age is not the solution to the retirement crisis.

Advantages:

- The worker receives more income and continues working a job that interests him/her.

CONCLUSION

America's pensions are broken. Tax breaks for retirement plans are at an all-time high, while coverage has not budged in 30 years. Most Americans have less retirement income security than they did a generation ago. However, taxpayers' subsidies for the 401(k) plans of the wealthiest Americans keeps growing. Tax breaks for 401(k) plans amounted to \$110 billion in 2006, most of which went to households in the top tax brackets. Not only do these tax breaks go to those who need them the least, they do not increase savings rates.

The GRA plan calls for the enrollment of all workers not in an equivalent defined benefit pension. Employers and employees contribute a total of 5 percent of pay, which will earn a guaranteed and inflation-protected rate of return. These funds will

The share of older workers who say they have physically demanding jobs is increasing, while the share of jobs reported as easy is falling. The incidence of requirements for stooping, bending, and using keen eyesight and intense concentration is increasing.

Disadvantages:

- Working in old age degrades the health of the worker.
- Workers cannot take care of dependent family members.
- High rates of long-term unemployment and falling wages are prevalent among elderly workers.
- Older workers face age discrimination from employers.

be converted to life annuities upon retirement.

This plan pays for itself--it will not increase the federal deficit or require a tax increase--by eliminating all tax deductions for contributions to 401(k) plans. Defined benefit plans keep their tax-favored status. The GRAs are administered by the Social Security system eliminating all individual account management fees.

Retirement security cannot be paid for by workers, employers, or the government alone -- guaranteeing a basic income floor requires shared responsibility. Additionally, workers simply have to save more to be able to retire.

Mandating contributions through a guaranteed retirement account would subsidize low-income and middle-class workers. Risks that individual retirees bear under defined contribution plans, such as longevity (outliving one's savings) or unstable markets, would be shouldered by the federal government. Accumulations would be sufficient by removing the problem of account leakages through skipped contributions, costly fees, and early withdrawals. In all, tax subsidies for

retirement accounts raise the national savings rates and secure Americans' retirement futures.

Critics of the GRA plan point out that it is politically unrealistic. But growing support for government action in the arena of retirement – shown by the popularity of Secure Choice Pensions in states across the nation – has pushed the GRA into the realm of the politically realistic, rather than just the necessary.

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