Securing Our Financial Future:

Report of the Commission on Retirement Security and Personal Savings

June 2016

BIPARTISAN POLICY CENTER

Commission on Retirement Security and Personal Savings

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Charles P. Blahous III, Ph.D.
Senior Research Fellow and Director of the Spending and Budget Initiative, Mercatus Center, George Mason University
Research Fellow, Hoover Institution, Stanford University
Former Public Trustee of the Social Security and Medicare Trust Funds

John Hope Bryant
CEO and Founder, Operation HOPE
Member, President's Advisory Council on Financial Capability for Young Americans

James H. Douglas
Former Governor of Vermont
Executive in Residence, Middlebury College
Member, BPC Governor's Council

David Dreier
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Former U.S. Representative from California
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Gail D. Fosler
President, The GailFosler Group LLC
Former President and Chief Economist, The Conference Board

William G. Gale, Ph.D.
Co-Director, Urban-Brookings Tax Policy Center
Director, Retirement Security Project, The Brookings Institution

Teresa Ghilarducci, Ph.D.
Professor, Bernard L. and Irene Schwartz Chair in Economic Policy Analysis, The New School
Director, Schwartz Center for Economic Policy Analysis (SCEPA), The New School

C. Robert Henrikson
Former Chairman of the Board, President and CEO, MetLife, Inc.

Kilolo Kijakazi, Ph.D.*
Institute Fellow, Urban Institute

Brigitte C. Madrian, Ph.D.
Aetna Professor of Public Policy and Corporate Management, Harvard University

Robert D. Reischauer, Ph.D.
Distinguished Institute Fellow and President Emeritus, Urban Institute
Former Public Trustee of the Social Security and Medicare Trust Funds
Former Director, Congressional Budget Office

Alan Reuther
Former Legislative Director, United Auto Workers

* Participated on the commission but chose not to endorse the final report.

Dallas Salisbury
Resident Fellow and President Emeritus, Employee Benefit Research Institute

Sylvester J. Schieber, Ph.D.
Former Chairman, Social Security Advisory Board
Independent Economic Consultant

Antonio R. Villaraigosa
41st Mayor of Los Angeles
Senior Fellow, BPC

Staff

G. William Hoagland
Senior Vice President

Steve Bell
Senior Director of Economic Policy

Shai Akabas
Associate Director of Economic Policy

Brian Collins
Senior Policy Analyst

Kenneth Megan
Policy Analyst

Ben Ritz
Policy Analyst

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DISCLAIMER

This report is a product of BPC's Commission on Retirement Security and Personal Savings. The findings expressed herein are those solely of the commission, though no member may be satisfied with every formulation in the report. The findings and recommendations expressed herein do not necessarily represent the views or opinions of the Bipartisan Policy Center's founders or its board of directors.

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Letter from the Co-Chairmen

A large segment of Americans struggle to save for any purpose. Millions are anxious about their preparation for retirement as well as their difficulty accumulating a savings cushion for short-term unexpected needs. Policymakers are concerned about the consequences of insufficient retirement savings for individuals, families, and the nation. Recent economic headwinds — stagnating wages and weak economic growth — have heightened these anxieties.

The nation's retirement system has many strengths, but it is also experiencing challenges. Retirement and savings policies have evolved over the decades into a true public-private partnership. Assets in workplace retirement savings plans and Individual Retirement Accounts (IRAs) have grown dramatically over the last four decades, but too many Americans are still not preparing adequately. Social Security remains the base of financial support in old age for most Americans, yet the program faces substantial financing problems. A long history of bipartisanship built these systems to promote savings and improve retirement security, but much work lies ahead.

To address these challenges, the Bipartisan Policy Center launched the Commission on Retirement Security and Personal Savings in 2014. Over the last two years, our 19-member commission has carefully reviewed the issues and explored many potential approaches to boost savings and strengthen retirement security.

Members of the commission possess considerable expertise about the U.S. retirement system — including Social Security, employer-sponsored retirement plans, and personal savings. They have a variety of backgrounds and relevant experiences, including operating businesses and sponsoring employee-benefit plans, administering state and federal government agencies, serving as elected officials, advocating for workers, advising large companies on their retirement plans, and conducting research on savings and retirement policy. We thank them for their commitment and willingness to find common ground.

No relevant policy idea was off limits. Commissioners considered many ways to build on strengths and address weaknesses in savings and retirement security. Our deliberations benefited from extensive modeling simulations, conducted for us by the Urban Institute. They showed the impact of various policies on savings and income for older Americans. Results of these simulations are included throughout the report.

All commissioners came to the Social Security discussions with strongly held views. Therefore, not surprisingly, our Social Security negotiations were particularly challenging. In the interest of encouraging compromise and informing the public debate, the commissioners operated under the restriction of a roughly 50-50 balance between increased revenues and changes to benefits in future years. Not all commissioners agree with this constraint. Some want proposals with more revenues, while others prefer greater changes to benefits compared to current policy. Nevertheless, all signatories to the recommendations agree that if the constraint of a 50-50 balance between increased revenues and changes to benefits in future years is adhered to, then the Social Security package put forward by the commission is a balanced, effective and good set of proposals.

We are encouraged that the issues of savings and retirement security have attracted bipartisan interest among business leaders, the media, elected officials in Congress, the administration, and the states, as well as from candidates seeking public office. We hope that the commission's recommendations will contribute to meaningful action by individuals, businesses and government to achieve a secure retirement future for all Americans.

Sincerely,

JAMES B. LOCKHART III **KENT CONRAD**

Executive Summary

Retirement challenges dominate media headlines and present policymakers with a tremendous opportunity for action. Tectonic shifts in demographics, policy, and the marketplace have transformed the U.S. retirement landscape. The most profound change has been an ongoing shift by many employers from defined benefit pensions to defined contribution plans. As a result, 401(k) — previously an obscure section of the tax code — has become a household name.

Workers have found themselves part of a great experiment — one that has given individuals and families far more control and responsibility for financing their own retirement, and simultaneously exposed them to greater risk. Some families are preparing appropriately, but others struggle to save for retirement while meeting competing, and often more-immediate, personal needs related to emergencies, homeownership, and education.

As average longevity increases, Americans need to save more or work longer if they hope to maintain their standard of living during retirement. While Social Security, the foundation of the U.S. retirement income system, is paying benefits over more retirement years, the current benefit schedule is underfunded.

Given all of these changes and risks, it is no surprise that Americans are anxious about retirement. Many are uncertain about what they should do to prepare. As the retirement system evolves, Americans need up-to-date guidance and better information to navigate a path to long-term financial security.

Today, more than in the past, personal responsibility is of central importance in retirement preparedness — individuals and families can't afford to take a passive approach to retirement savings — but that doesn't mean everyone should be or can be on their own. People need the assistance of a well-designed system as they accumulate, invest, and spend down their retirement savings. Public policy has a critical role to play in facilitating savings and a secure retirement.

This report presents a comprehensive package of bipartisan proposals to address six key challenges:

- Many Americans' inability to access workplace retirement savings plans;
- Insufficient personal savings for short-term needs, which too often leads individuals to raid their retirement savings;
- Risk of outliving retirement savings;
- Failure to build and use home equity to support retirement security;
- Lack of basic knowledge about personal finance; and
- Problems with Social Security, including unsustainable finances, an outdated program structure and failure to provide adequate benefits for some retirees.

Taken together, the recommendations contained in this report aim to establish a better savings culture and renew the promise of an adequate retirement — across the income spectrum — for current and future generations of Americans.

Improve Access to Workplace Retirement Savings Plans

Too many Americans, especially those who work for small businesses, lack access to a payroll-deduction workplace retirement savings plan. This is partly because offering such plans entails burdens and costs that employers may be unwilling or unable to bear.

We recommend the creation of a new, streamlined option called *Retirement Security Plans* that would allow small employers to transfer most responsibilities for operating a retirement savings plan to a third-party expert, while still maintaining strong employee protections. We would also enhance the existing myRA program to provide a base of coverage for those workers, such as part-time, seasonal, and low-earning workers, who are least likely to be offered a retirement savings plan.

Other workers have access to retirement savings plans but do not contribute. We propose an alternative to nondiscrimination testing along with new tax incentives to encourage employers to adopt automatic enrollment and escalate their employees' contributions over time.

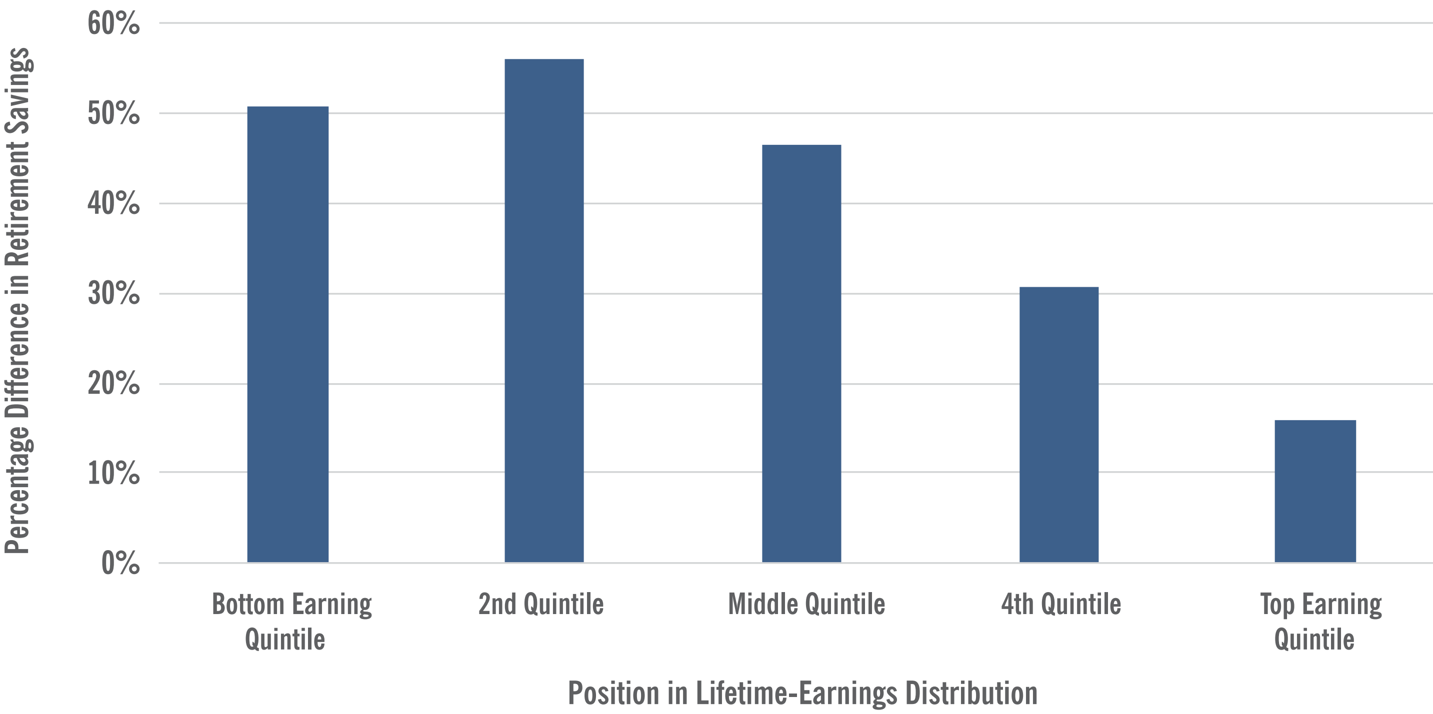
Once these reforms are in place, we recommend establishing a nationwide minimum-coverage standard to pre-empt the patchwork of state-by-state regulation that is already developing. Beginning in 2020, employers with 50 or more employees that do not already offer a retirement plan that meets certain minimal thresholds would be required to automatically enroll employees into a new Retirement Security Plan or myRA. This would ensure broad access to workplace retirement savings plans while minimizing the burden for employers. Employees would have the ability to change contribution amounts or opt out of contributing entirely.

A variety of additional reforms could support greater access to retirement savings plans and improve the experience of plan participants. We would encourage lower-earning individuals to save for retirement by improving the existing Saver's Credit for younger workers and by exempting some retirement savings from asset tests to qualify individuals for certain federal and state assistance programs. We also recommend several additional actions, including the creation of a Retirement Security Clearinghouse to help Americans consolidate their retirement savings, steps to limit over-exposure to company stock, and modest adjustments to retirement tax expenditures.

Multiemployer defined benefit plans, which are organized by more than one employer and a labor union, are experiencing financial challenges. We recommend the creation of *Lifetime Income Plans* — a new, more-sustainable retirement-plan design that could

Figure 1. Retirement Savings for Lower- and Middle-Earners Grow Significantly Under Minimum-Coverage Standard

Projected change in retirement savings among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings.



Note: Retirement savings include savings in defined contribution plans, such as 401(k) plans, IRAs, and Keogh plans, which are available to self-employed individuals. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household assets. Modeling assumptions and methods are discussed on page 47.

Source: The Urban Institute - DYNASIM3

be adopted on a voluntary basis. This new plan design would blend the strengths of defined benefit and defined contribution plans by incorporating elements of both approaches.

Promote Personal Savings for Short-Term Needs and Preserve Retirement Savings for Older Age

Americans need to increase their personal savings so that they are better positioned to handle emergencies and major purchases. Insufficient short-term savings can lead workers to draw down their retirement accounts, incurring taxes and (often) penalties. This "leakage" of retirement savings — while it might address an immediate financial squeeze — jeopardizes many Americans' long-term retirement security. To address this issue, we recommend clearing barriers that discourage employers from automatically enrolling their employees in multiple savings accounts, one for short-term needs and another for retirement.

Some leakage of retirement savings results from system complexity and poorly designed regulation. We propose to ease the process for transferring savings from plan to plan, because many pre-retirement withdrawals occur upon job separation. In addition, early-withdrawal rules and penalties for workplace plans and Individual Retirement Arrangements (IRAs) should be harmonized by raising IRA standards.

Reduce the Risk of Outliving Savings

Longevity risk, the possibility that retirees will outlive their savings, is a growing and significant threat to retirement security. Social Security, defined benefit pension plans, and life annuities from insurance companies all leverage the power and efficiency of mortality pooling to help individuals manage the risk of longevity. Yet many defined benefit plan participants choose a lump-sum distribution instead of monthly income for life, and few purchase life annuities with their retirement savings. While Social Security provides a form of lifetime income, Social Security benefits alone will not be adequate to meet all income needs for most retirees. For those who have accumulated sufficient savings, other lifetime-income solutions offer the security of an added, regular retirement income that they cannot outlive.

We recommend that plan sponsors integrate sophisticated but easy-to-use lifetime-income features within retirement savings plans. For example, it should be easy for plan participants to purchase a guaranteed lifetime-income product in automatic installments. Plan sponsors could establish a default lifetime-income option or offer an active-choice framework, in which participants are asked to choose options from a customized menu. In-plan tools could also help participants make an informed decision about when to claim Social Security benefits and then to schedule withdrawals from their retirement plan to facilitate later claiming of Social Security benefits. We believe employers need safe harbors to limit their legal risk as they offer these features and attempt to educate workers about longevity risk and lifetime income.

Additionally, we recommend clearing barriers to offering a wider array of choices for lifetime income in both retirement savings and pension plans. In defined contribution plans, participants aged 55 and older should be allowed to use their retirement savings to purchase annuities that begin payments later in life. Workers with defined benefit pensions should be able to receive part of their benefit as a lump sum and the rest as monthly income for life, rather than the all-or-nothing choice most have today. Also, to encourage participants to work longer and provide more-consistent work incentives, we recommend allowing employer-sponsored retirement plans to align plan retirement ages with Social Security.

Facilitate the Use of Home Equity for Retirement Consumption

Housing is an important form of savings. Americans own more than $12.5 trillion in home equity — a sum that rivals the $14 trillion that Americans hold in retirement savings.[1, 2] For individuals or couples who lack substantial savings in a retirement plan but who own their residence, homeownership can be a major source of retirement security. A variety of mechanisms exist for tapping home equity to fund regular consumption needs in retirement; for example, homeowners can downsize, use a reverse mortgage, or sell their home and rent instead. These approaches have advantages and drawbacks; retirees with home equity should be aware of the available alternatives and have independent advice to make an appropriate choice for their circumstances.

Federal and state tax policy, however, actually subsidizes the use of home equity for pre-retirement consumption, leaving many retired homeowners burdened with debt and with less equity to support retirement security. We recommend ending these subsidies by eliminating tax benefits for borrowing that reduces home equity.

We also propose to strengthen programs that support and advise consumers on reverse mortgages, which can be a good option for some older Americans. Establishing a low-dollar reverse-mortgage option would facilitate smaller loans while reducing fees for borrowers and risk for taxpayers.

Improve Financial Capability Among All Americans

Financial capability — defined as having the knowledge, ability, and opportunity to manage one's own finances — is lacking among too many Americans.[3, 4] This is a troubling fact at a time when the nation's retirement system has transitioned toward greater individual control and responsibility.

Exposure to financial knowledge and planning should begin early in life, with schools, communities, employers, and federal and state governments all working to foster a culture of savings and to position individuals to make prudent financial choices. We support a variety of approaches, including implementing recommendations from the President's Advisory Council on Financial Capability, providing improved personal financial education through K-12 and higher-education curricula, and better communicating the consequences of claiming Social Security early. For example, renaming the earliest eligibility age, currently age 62, as the "reduced benefit age" would better highlight the lower monthly benefits that result from early claiming.

Strengthen Social Security's Finances and Modernize the Program

Social Security provides the income foundation for many older Americans, but to maintain that legacy, prompt adjustments to the program are needed. For decades, the program's trustees have affirmed the need for changes, noting that Social Security faces significant financial challenges. In 2015, the trustees recommended "that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes gradually and give workers and beneficiaries time to adjust to them."[5] Moreover, Social Security has not been updated to reflect a 21st century workforce and society.

Uncertainty about Social Security's future magnifies the anxiety that many Americans experience as they plan and prepare for retirement. That is why any comprehensive effort to improve retirement security must shore up and modernize the program.

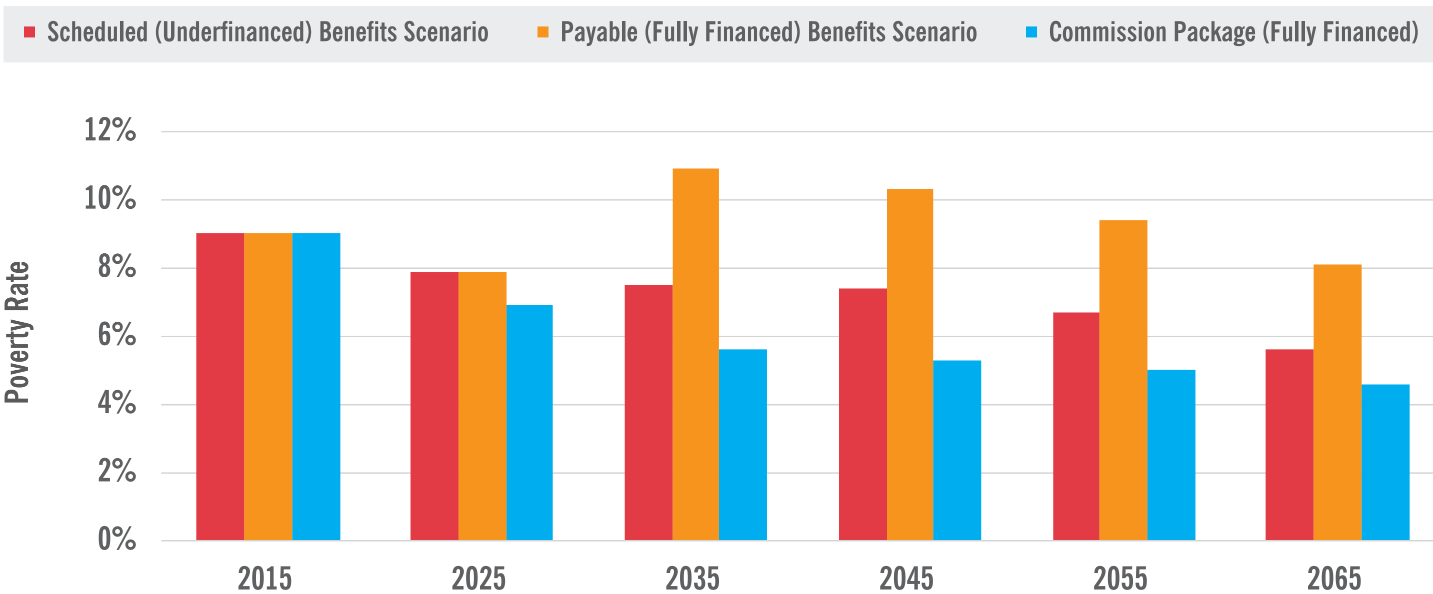
We recommend adjustments to Social Security's tax and benefit levels to 1) reflect changing demographics; 2) better target benefits on those who are most vulnerable in old age, including surviving spouses and workers in low-earning occupations; 3) preserve reasonable intra- and inter-generational equity; and 4) more fairly reward work. Americans ought to know what they stand to gain from extending their working lives and claiming benefits later — both of which are highly effective ways for individuals to raise their retirement income. Clearer work incentives in the Social Security program would increase understanding of these options and promote better decisions.

What Do "Payable" and "Scheduled" Mean?

Under current law, if Social Security's trust funds are empty, the program cannot spend more on benefits than it is collecting in revenues. The program's trustees project that savings in the trust funds will be depleted by 2034.[6] Any proposal to adjust Social Security benefits is typically compared with two post-2034 scenarios: scheduled benefits and payable benefits. These terms are confusing to many. The payable scenario assumes that, once trust fund savings are depleted, benefits will be limited to levels that could be financed with funds from existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits will be paid according to the existing benefit formula despite insufficient Social Security tax revenues to finance these benefits. Under current law, such benefits cannot be paid.

Figure 2. Commission's Social Security Proposals Would Reduce Poverty Among Older Americans

Projected poverty rates among individuals aged 62 and older under various Social Security scenarios: benefits payable under current law, scheduled (but underfinanced) benefits, and the commission's proposals.



Note: The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient Social Security tax revenues to finance these benefits.

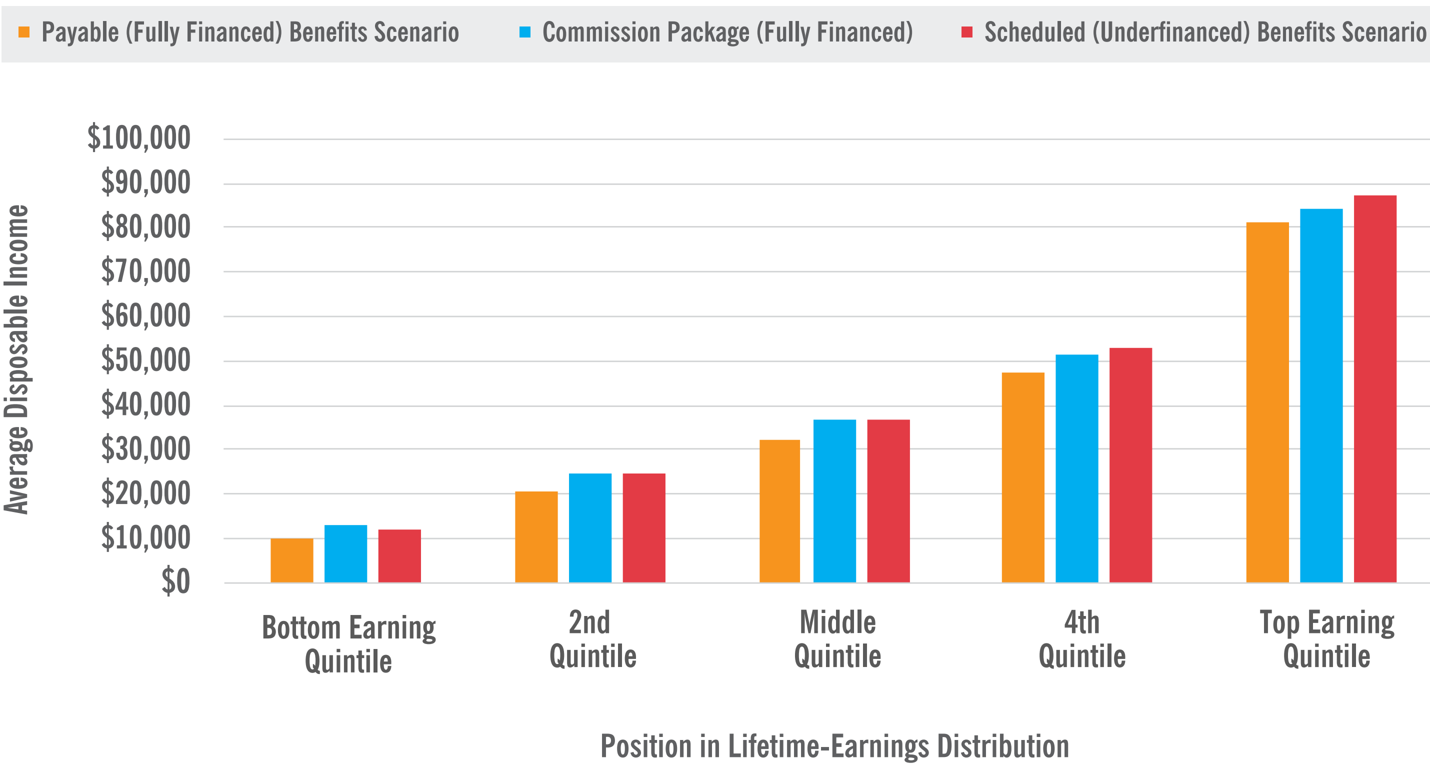
Source: The Urban Institute - DYNASIM3

The good news is that shoring up Social Security is feasible. But, taking the needed actions requires political leadership — and sooner rather than later. The cost of fixing the program grows as corrective action is delayed. A package of reforms that balances changes to scheduled benefits, which cannot be financed by current dedicated taxes, with changes to revenues would renew the promise of Social Security and reassure Americans that the program will remain strong for decades to come.

Our recommendations on Social Security, pensions, and other savings complement one another in a variety of ways. In particular, the measures that we have proposed to expand workplace retirement savings and to reform Social Security would maximize retirement-security outcomes. Taken together, our recommendations would achieve incomes for older Americans that are above payable-benefit scenarios throughout the lifetime-earnings distribution.

Figure 3. Commission's Proposals for a Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Achieve Incomes for Older Americans At or Above Scheduled Levels for Both Lower- and Middle-Earners

Projected average disposable income (in 2015 dollars) among individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission's Social Security proposals.

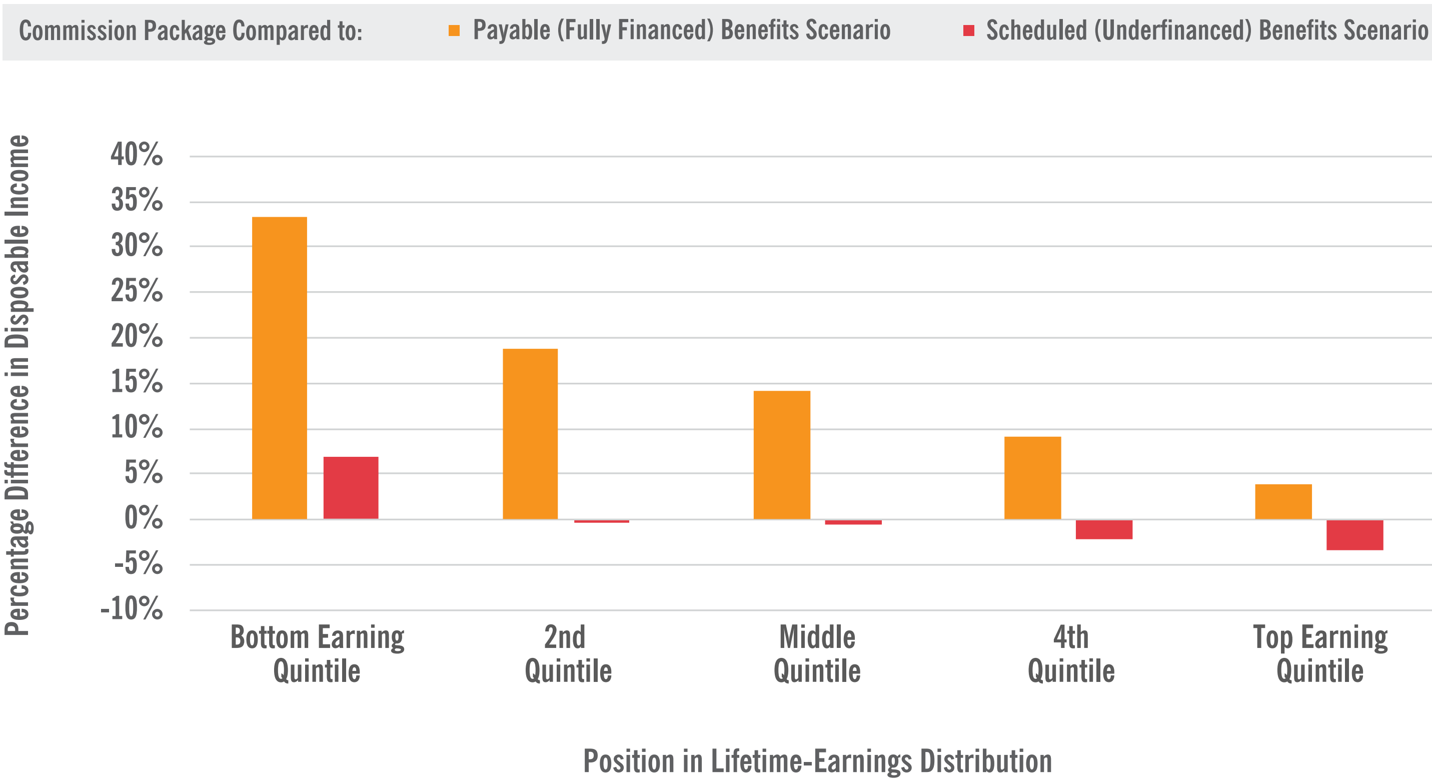


Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as the Supplemental Nutrition Assistance Program (SNAP). The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

Figure 4. Commission's Proposals for Workplace Retirement Savings Minimum-Coverage Standard and Social Security Reform Would Increase Progressivity and Protect Lower- and Middle-Earners from Abrupt Changes

Projected change in disposable income for individuals aged 62 and older in 2065 under near-universal access to workplace retirement savings and implementation of commission's Social Security proposals.



Note: Disposable income includes cash income from all sources, such as Social Security benefits and retirement account withdrawals, after subtracting taxes and Medicare premiums. Disposable income does not include cash equivalents from in-kind benefit programs, such as SNAP. The payable scenario assumes that benefits are limited to levels that can be financed with existing, dedicated Social Security taxes. The scheduled scenario assumes that benefits are somehow paid according to the existing benefit formula despite insufficient revenue to finance them. Population is segmented based on lifetime earnings; for example, the bottom quintile represents those individuals whose total career earnings (including wages and salaries) were in the lowest 20 percent of all Americans. Figure is presented on a per-capita basis, which means that estimates are for individual persons, assuming that couples equally divide household income.

Source: The Urban Institute - DYNASIM3

As **Figure 4** shows, these proposals would especially benefit lower earners and would protect Americans across the earnings spectrum from the damaging reductions in old-age income that would otherwise result if Social Security benefits were limited to levels that are payable with existing Social Security taxes.

Thus, our recommendations aim to bring peace of mind to Americans preparing for retirement by assuring the financial sustainability of the Social Security program and by significantly expanding access to workplace retirement savings plans. Together, these changes would help many more workers take charge of their financial futures.

We understand that the problems discussed in this report will be challenging for policymakers to address. But, policymakers also have a compelling opportunity to improve the retirement security of all Americans. We hope that this report strengthens the impetus for action.

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